No. 546

In the Supreme Court of the United States

October Term, 1959

Alden D. Stanton and Louise M. Stanton, petitioners

v.

United States of America

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
WAYNE G. BARNETT,
Assistant to the Solicitor General,
Department of Justice, Washington 25, D.C.

INDEX

543845—60——1

CITATIONS

Cases—Continued

Cases—Continued

Cases—Continued

Statutes:

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 546

ALDEN D. STANTON AND LOUISE M. STANTON, PETITIONERS

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The majority and dissenting opinions in the Court of Appeals (R. 82–89) are reported at 268 F. 2d 727. The District Court rendered no opinion; its one-sentence findings of fact and conclusions of law (R. 60) are not reported. The District Court's memorandum opinion denying petitioners' motion for summary judgment (R. 11–15) is reported at 137 F. Supp. 803.

JURISDICTION

The judgment of the Court of Appeals was entered on July 6, 1959 (R. 90), and timely petitions for rehearing were denied on July 30, 1959, and October 22, 1959 (R. 90–91). The petition for certiorari was filed on November 27, 1959, and granted on December 14, 1959 (R. 91; 361 U.S. 923).

QUESTION PRESENTED

Whether a "gratuity" given by a corporation to a resigning officer "in appreciation of" his past services is a gift excludible from income under § 22(b)(3) of the Internal Revenue Code of 1939.

STATUTES INVOLVED

The principal statutory provision involved is § 22(b)(3) of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.), which excludes from gross income the "value of property acquired by gift * * *." That section, and other statutory provisions pertinent to consideration of this case, are set out in Appendix A, *infra*.

STATEMENT

Petitioner [1] was the comptroller of the Corporation of Trinity Church in New York City and the president of its real estate holding corporation, the Trinity Operating Company, both of which were tax-exempt organizations. His salary was $22,500 (R. 54–55). On November 5, 1942, petitioner resigned from both offices, effective November 30 (R. 67, 68–69). On November 19, 1942, the board of directors of the Operating Company adopted the following resolution (R. 61–62):

> *Be it resolved* that in appreciation of the services rendered by Mr. Stanton as Manager of the Estate and Comptroller of the Corporation of Trinity Church throughout nearly ten

[1] Alden D. Stanton will be referred to as the sole petitioner, his wife being a party only because they filed joint income tax returns.

> years, and as President of Trinity Operating Company, Inc., its subsidiary, a gratuity is hereby awarded to him of Twenty Thousand Dollars, payable to him in equal installments of Two Thousand Dollars at the end of each and every month commencing with the month of December, 1942; * * *.

The resolution was approved by the vestry of the church (R. 21–22), and approximately half of the payment ($9,600) was paid by the church (R. 12). The payments were entered on the books of the operating company and the church as a gratuity (R. 32–33), and neither withheld income taxes or reported the payment on an information return (R. 23, 38).

In his federal income tax return for 1942 and 1943, petitioner disclosed the receipt of the $20,000 but claimed that it was excludible as a gift under § 22(b)(3) of the Internal Revenue Code of 1939.[2] Upon a deficiency being asserted, petitioner paid the additional tax and in due course, on June 11, 1954, brought this suit for refund (R. 4–8).

Woolsey A. Sheppard, who, as general counsel of the church and the operating company, had drafted the resolution and, as a director and vestryman, had voted for its adoption, testified (R. 27):

> Q. At the time you voted on the resolution, Mr. Sheppard, what was your intention?
> A. To give Mr. Stanton a gift.

* * * * *

[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.).

Q. Can you state what the intent of the board of directors was in adopting such resolution?

A. Yes, based on the discussion which took place in the meeting, Mr. Stanton was liked by all of the Vestry personally. He had a pleasing personality. He had come in when Trinity's affairs were in a difficult situation. He did a splendid piece of work, we felt. Besides that, as I say, he was liked by all of the members of the Vestry personally.

Q. Is it your testimony, Mr. Sheppard, that it was the intention of the Board of Directors to make Mr. Stanton a gift?

A. No question about it.

Frederick E. Hasler, who was the Chairman of the Standing Committee of the Vestry and a director of the operating company, and who voted for the resolution in both capacities, testified (R. 37):

Q. * * *

Could you possibly recall anything which you or any other member of the Board said at that time?

A. Yes, sir, we were all unanimous in wishing to make Mr. Stanton a gift.

Mr. Stanton had loyally and faithfully served Trinity in a very difficult time. We thought of him in the highest regard.

We understood that he was going in business for himself.

We felt he was entitled to that evidence of good will.

At the close of the trial, the district court entered a finding that the resolution "whereby a gratuity was

voted to the plaintiff * * * in the amount of $20,000 * * * constituted a gift" (R. 60). The court of appeals, in an opinion by Judge Hand, with Judge Swan concurring and Judge Hincks dissenting, reversed (R. 82–89).

SUMMARY OF ARGUMENT

I

In the area represented by this case—voluntary payments by an employer to an employee or his family—there have been well over one hundred decisions in the lower courts, yet the principles governing decision remain unclear and uncertain. The reason, we believe, is that the "intent" test which the courts generally apply is not susceptible of being given meaningful content. The "intent" formulation came into the tax law only by uncritical reliance on a property law definition the irrelevance of which is now universally accepted, and with the rejection of that definition it must also fall.

II

A. It is our view that the only factual distinction that can be drawn among different kinds of voluntary payments is the difference in the reasons why they are made, *i.e.*, motive, and any useful definition of gifts must make the legal consequences, for tax purposes, turn on that distinction. It is our purpose in this brief to outline such a definition and examine its implications.

B. The definition of a gift we propose is a transfer of property motivated by personal, as distinguished

from business, reasons. "Personal" reasons include, of course, the motivations of affection, charity and the like that are usually associated with gifts, but it must be recognized that they can be limited neither to free-flowing nor to admirable motivations. Many, if indeed not most, admitted gifts spring rather from a sense of "duty"—to family, to society, to God—and the definition must equally include such motives as hate, vindictiveness, or self-aggrandizement. What such motives have in common is not their quality, or even the lack of compulsion, but the fact that they are "personal" to the payor in the sense that they arise from his relationship as a human being to others, to society, or to God. In the end, they can be usefully defined only by excluding "business" reasons.

"Business" reasons comprise any reason that establishes a proximate causal relationship between the payment and the performance of services, the conduct of a business, or the production of income. "Proximate" implies a standard broadly equivalent to the accounting concepts governing the propriety of charging a payment as a "cost" of the business, and can be made most concrete by identifying it with the degree of relationship necessary to justify a business deduction. In short, if a payment is sufficiently related to the business to be a proper charge against the business profits for tax purposes, then it ought equally to be deemed sufficiently related not to qualify as a gift. It is only the standard of causal relationship that is the same, however, and it makes no difference whether the particular payor claimed a deduc-

tion or whether, for some other reason, the payor would not be entitled to it.

That definition conforms to the substantial underlying considerations that can be perceived in the decided cases and is fully supported by the statute, provides a workable and easily-applied principle, and is consistent with the decisions of this Court.

C. The statute, which seems rarely to have been examined in this area, indicates both that Congress had in mind only essentially "personal" transfers and that it could not have intended to exclude payments of a kind that would be deductible by the payor.

The exclusion applies to "property acquired by gift, bequest, devise, or inheritance." Transfers at death are, of course, primarily intra-family matters and are uniquely "personal" even extended beyond the family. "Gifts" included in the same category reflect the same kind of transfer accomplished *inter vivos,* and there is no reason to think that Congress intended also to exempt a whole range of "business" transfers. That inference is also supported by the interrelationship of the income, gift, and estate taxes. Corporations are not subject to the gift tax, and if corporations can make gifts—*i.e.,* if a payment made for a business reason can be a gift—it means such transfers are subject to neither tax.

Even stronger is the evidence that Congress did not intend to permit "deductible gifts". The result of a deductible gift is that income that would have been taxed to the payor but for the transfer is never taxed. Congress was at pains, however, to prevent that result,

as is evidenced both by the exception from the gift exclusion of gifts "of income" and the basis provisions assuring that any unrealized appreciation at the date of the gift will ultimately be taxed to someone. A construction of the gift exclusion which permits exclusion of payments the payor may deduct is fundamentally inconsistent with the statutory design.

D. Since the funds of a corporation ordinarily cannot properly be expended for the sort of personal reasons essential to a gift, the presumption that the directors did not commit a breach of trust by expending corporate funds for personal purposes ordinarily resolves the question of fact whether a corporate payment was made for personal reasons. And, since virtually all the litigated cases have involved payments by corporations, the definition of gift proposed by the Government would resolve most of the cases almost automatically. A question of fact as to the reasons for the payment would be raised only by the rare case in which the recipient contended, in effect, that his benefactors had committed a breach of trust.

E. More difficult, but less important as a practical matter, are the factual issues posed by payments by individuals. If nothing else, however, a great contribution is made simply by clarifying what it is that the trier of fact is to look for.

III

A. The essential elements of the formulation urged here are directly supported by this Court's most recent decisions in this area, *Robertson* v. *United States*, 343 U.S. 711, and particular *Commissioner* v. *LoBue*,

351 U.S. 243. As we show in our *Duberstein* brief, *LoBue* seems clearly to reject "intention" as the dividing line between gifts and income and to establish that the reason why a payment is made is the only relevant inquiry. So also, it made clear that a payment made for a business reason could not be a gift.

B. The opinion that seems most inconsistent with the approach later adopted by the Court is *Helvering v. American Dental Co.*, 318 U.S. 322, holding a cancellation of indebtedness, admittedly made for business reasons, to be a gift, and defining a gift as simply "the receipt of financial advantages gratuitously." That decision, however, has already been substantially overruled by *LoBue*, *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, and *Commissioner v. Jacobson*, 336 U.S. 28.

C. The difficulty that *Bogardus v. Commissioner*, 302 U.S. 34, seems to have caused in the lower courts is due not to its holding but only to the Court's unguarded use of the language of "intent" when its own analysis seems clearly to have turned on "motive." Properly understood, both the majority and dissenting views in that case—their disagreement being only over the scope of review, not the substantive definitions—can be readily reconciled with the later decisions of the Court and the definition of gifts urged here.

IV

If our definition of gifts be correct, no difficulty is posed by its application to this case. The only reason for which the vestrymen could properly have paid

funds of the church, dedicated to religious purposes, to petitioner was as a just reward for his past services. Unless it is to be contended that they committed a breach of trust by giving church assets to a personal friend—which of course is not contended—the fact that they may also have liked petitioner is totally irrelevant. When using church funds, they act for the church, not for themselves, and the only reason relevant here is the reason which justified the use of the church funds. And if reward for services was the reason for the "gratuity", it cannot be a gift. Not being a gift, it necessarily is, on the facts here, compensation, no matter how sincerely and genuinely the vestrymen "intended" to make a gift not taxable to petitioner.

ARGUMENT

I

INTRODUCTION—THE NEED FOR CLARIFICATION OF THE LEGAL TEST FOR DISTINGUISHING BETWEEN GIFTS AND INCOME

It is in the area represented by this case—voluntary payments by an employer to a present or former officer or employee, his estate, or his family—that the great bulk of federal tax litigation over the distinction between gifts and income has taken place. Beginning with 1 B.T.A. 1 (*Parrott* v. *Commissioner*), there have been well over a hundred decisions dealing with the problem. Their failure in developing clear and meaningful guiding principles, however, is demonstrated by the most recent of all, *United States* v. *Allinger*, decided by the Court of Appeals

for the Sixth Circuit on March 3, 1960 (set forth in Appendix B, *infra,* pp. 91–94).

In *Allinger,* the two principal officers and stockholders of a corporation owned almost entirely by their two families agreed with each other that, upon the death of either, the corporation would pay a year's salary to his widow. Upon the death of one, the board of directors adopted a resolution confirming the agreement and resolving that "in consideration for past services" the corporation would pay a year's salary to the widow. The widow of the deceased officer thereupon received $35,000. The district court found the payment to be a gift, and the court of appeals affirmed, noting that the widow was not required to perform any services and saying (*infra,* pp. 93–94):

> "The question presented is one of fact. Whether the payment was a gift or taxable income * * * depends upon the intention of the parties, particularly that of the donor. The intent of the donor is to be determined from a consideration of all the facts and circumstances surrounding the payment." *U.S. v. Bankston,* 254 F. 2d 541 (C.A. 6). Intention must govern. *Bogardus* v. *Com. of Internal Rev.,* 302 U.S. 34, 43.
>
> There are many cases on the subject but the thread running through all of them is that each case must be judged upon its own merits. There is no exact standard of measurement. The court must consider the peculiar facts of each case and determine whether from them an intention to make a gift is manifested and

543845—60——2

if the facts logically and reasonably support such a conclusion. See the following cases: *Commissioner of Internal Revenue* v. *Jacobson*, 336 U.S. 28, 51; *Bounds* v. *United States*, 262 F. 2d 876, 884 (C.A. 4); *Peters* v. *Smith*, 221 F. 2d 721 (C.A. 3).

The Trial Judge made a careful comprehensive "findings of fact" and drew his inferences and conclusions therefrom. He had an opportunity to observe the witnesses and form a judgment of their sincerity, honesty and intentions not available to a reviewing court. We are of the opinion that the facts as found warrant the conclusions and inferences which he drew from them. Under Rule 52(a) F.R.C.P. we are not to disturb those "findings" unless clearly erroneous.

It is fair to say that the quoted opinion is typical of the approach widely followed in the lower courts, which while stating the question to be one of fact does not illumine which facts are or are not significant in resolving the question. Because the decisions by and large are limited to a recitation of the evidentiary facts and a conclusory "inference" that the payment was either intended or not intended as a gift, the full scope of the problem can be seen only by scanning the results of the cases. Rather than attempt to summarize them here, we have included in Appendix C brief summaries of a comprehensive, but not all-inclusive, group of the decisions. Our purpose here will be only to show how that lack of meaningful principles has come about.

A. THE INTENT FORMULATION OF THE GIFT ISSUE, WHICH HAS ONLY PRODUCED CONFUSION, WAS UNCRITICALLY TAKEN FROM THE PROPERTY LAW AND HAS NO MEANINGFUL UTILITY FOR DIFFERENTIATING BETWEEN THOSE "GIFTS" IN THE PROPERTY-LAW SENSE WHICH ARE TAXABLE RECEIPTS OF INCOME AND THOSE WHICH ARE NOT

The basic reason for the present unsatisfactory state of the lower-court law, we believe, is that the "intent" test by which the courts have sought to resolve the cases is simply not susceptible of being given meaningful content. We have tried to show that lack of content in our *Duberstein brief* (No. 376, pp. 9-12), and will not repeat it here. Our purpose here is to show that even in its origin the rule was never sought to be justified, and was adopted only through an uncritical borrowing of the concept from an irrelevant context while at the same time necessarily divorcing it from its original meaning.

1. *The property law definition of gifts is irrelevant for tax purposes*

1. That an effective transfer of property by gift requires a delivery, an intention to convey title (donative intent), and an acceptance by the donee is elementary, but there is one common law case, *Gray* v. *Barton*, 55 N.Y. 68, that has had such a particular significance that it is well to begin with it. There, Gray, admittedly intending to make a gift, purported to cancel an indebtedness owed him by Barton by giving to Barton, in exchange for one dollar, a receipt for "one dollar, in full, to balance all book accounts." Later, however, Gray sued Barton on the debt, claiming that part payment of the debt was not

consideration for a discharge of the whole and the purported cancellation was ineffective. The court held that, although there was no consideration to support an executory transaction, the delivery of the receipt was an adequate delivery to effect a completed gift of the debt, there being no doubt that a gift was intended. In the course of its opinion, the court said (p. 72):

> A gift may be defined as a voluntary transfer of his property by one to another, without any consideration or compensation therefor. To make it valid, the transfer must be executed, for the reason that, there being no consideration therefor, no action will lie to enforce it. To consummate a gift there must be such a delivery by the donor to the donee as will place the property within the dominion and control of the latter, with intent to transfer the title to him.

2. Since in virtually all of the litigated income tax cases there has admittedly been an effective transfer of property without consideration in the common law sense, it is evident that if that definition of a "gift" were adopted for tax purposes, there would be no issue and all "voluntary" and "gratuitous" payments would be exempt as "gifts." If one thing is clear, however, it is that that is not the rule. Rather it was assumed even before the dictum in *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 730, and since then has been universally regarded as settled, that a payment made without obligation and not in exchange for a bargained-for consideration is not nec-

essarily a "gift" for tax purposes and may be compensation.[a]

To complete the showing of the irrelevance of the property law definition of gifts, it is necessary only to add that the converse is also true, namely, that even the presence of consideration in the common law sense does not necessarily preclude a transfer from being a gift for tax purposes. For example, while nominal consideration might be sufficient to make a contract enforcible, the transaction might still qualify as an excludible gift. A man may contract with his grandson to pay his tuition if the latter will agree to go to college. The existence of common-law consideration does not preclude the characterization, for tax purposes, of a gift.

In short, it is apparent that the fact that there has been an effective voluntary transfer of property, intended as such—*i.e.,* a property law "gift"—only creates the tax question and does not answer it. Necessarily, therefore, to answer the tax question, reference must be made to some other source than the property law definition.

---

[a] Virtually every case cited in this brief starts with that assumption. For express statements, see, *e.g.*: *Fisher* v. *Commissioner*, 59 F. 2d 192 (C.A. 2); *Lunsford* v. *Commissioner*, 62 F. 2d 740 (C.A. 6); *Bass* v. *Hawley*, 62 F. 2d 721 (C.A. 5); *Levey* v. *Helvering*, 68 F. 2d 401 (C.A.D.C.); *Poorman* v. *Commissioner*, 131 F. 2d 946 (C.A. 9); *Nickelsburg* v. *Commissioner*, 154 F. 2d 70 (C.A. 2); *Bausch's Estate* v. *Commissioner*, 186 F. 2d 313 (C.A. 2); *Webber* v. *Commissioner*, 219 F. 2d 834 (C.A. 10); *Peters* v. *Smith*, 221 F. 2d 721 (C.A. 3); *Neville* v. *Brodrick*, 235 F. 2d 263 (C.A. 10); *Simpson* v. *United States*, 261 F. 2d 497 (C.A. 7); *Bounds* v. *United States*, 262 F. 2d 876 (C.A. 4); *Willkie* v. *Commissioner*, 127 F. 2d 953 (C.A. 6).

2. The tax definition generally used was taken directly from the property law definition

1. One of the earliest cases showing how the property-law definition of a gift, although itself irrelevant, was made to do service to make the tax distinction is *Daly* v. *Commissioner,* 3 B.T.A. 1042. There, the president of a corporation having become incapacitated by illness, the board of directors (consisting of the president himself and one other director) resolved to pay him "gifts" totalling $72,000 in two years. The payments were charged to surplus and were not deducted by the corporation on its tax returns. The payments were held to be nontaxable gifts to the president, the Board reasoning (p. 1044):

> * * * A gift has been judicially defined as "a valid transfer of his property from one to another without consideration or compensation therefor." Gray v. Barton, 55 N.Y. 68. The essential elements of a gift are an intention to give, a transfer of title or delivery, and an acceptance by the donee. Reviewing the evidence in this appeal, we find an actual delivery of the property and the acceptance by the donee. The intention may be ascertained from the resolutions of the board of directors and the subsequent treatment of the payments by the corporation. The three resolutions specifically designate the payments as "gifts," and the amounts thereof were posted in the corporate books to either the "profits" account or the "surplus" account, and were not treated as an operating expense of the business. This consistency of treatment was carried into the Federal tax returns * * *, wherein the amounts

> were not claimed as a deduction from gross income. * * * Viewing the evidence in the light of what we deem to be the essential characteristics of a gift, we are led to the conclusion that the payments to the decedent were gifts and should not therefore be included in his gross income for the years in question.

The Board distinguished two earlier cases on the ground that in them "one of the essential elements of a gift, namely, the intention to give," was "negatived by the treatment of the payments by the corporations as compensation for services and therefore as deductible items" (p. 1045).

In *Daly*, as in the other cases, it is clear that there was no more question about the "intention to give" in the property law sense than there was about "delivery" and "acceptance"; admittedly the transfer was valid for property law purposes. Thus the Board simultaneously, and apparently unwittingly, rejected the property law definition but borrowed its words, giving to them some entirely new and undefined meaning.

What *Daly* seemed to mean by an "intention to give" was simply a desire that the payment be treated as a gift for tax purposes, for the facts relied on reflect nothing else. And, indeed, as we show in *Duberstein* (pp. 9–12), that seems the only tangible meaning "intention" as so used can have. As might be expected, however, when that meaning was squarely put to the courts, it was squarely rejected—in cases holding payments not to be gifts even though admittedly the payor had done everything in his power to

treat them as gifts. *E.g., Levey* v. *Helvering,* 68 F. 2d 401 (C.A.D.C.); *Nickelsburg* v. *Commissioner,* 154 F. 2d 70 (C.A. 2); *Wallace* v. *Commissioner,* 219 F. 2d 855 (C.A. 5); *Thomas* v. *Commissioner,* 135 F. 2d 378 (C.A. 5). And in due course the Board of Tax Appeals expressly overruled *Daly*. *Van Sicklen* v. *Commissioner,* 33 B.T.A. 544; see also *Laurie* v. *Commissioner,* 12 T.C. 86; *Walker* v. *Commissioner,* 25 T.C. 832; *Silverman* v. *Commissioner,* 28 T.C. 1061. Since the very essence of "intent" would seem to be the power of choice, the recognition in those cases that the payor ought not be allowed to choose the tax consequences should have made clear that the fault lay with the "intent" test; instead, most courts continued to use the verbalization of "intent" but removed it a final step away from substantive content by saying that it was the payor's "real" intent, and not his "words", that was controlling.

2. Perhaps the major source of the interjection of property law concepts into the tax definition is *Noel* v. *Parrott,* 15 F. 2d 669 (C.A. 4). There, the board of directors, anticipating a sale of the stock and the consequent displacement of the incumbent officers, made a "gratuitous appropriation" of some $146,000 for distribution among the officers by the executive committee as it deemed "wise and proper." In holding the payments made pursuant to the resolution to be taxable, the court (per Parker, *J.*) said (p. 671):

> * * * A gift is a voluntary transfer of his property by one to another, without any consideration or compensation therefor. Gray v.

> Barton, 55 N.Y. 68 * * *; Curriden v. Chandler, 79 N.H. 269 * * *. Although it is held that the motive accompanying a gift is not material, gifts usually proceed from the generosity of the giver; and, where there is any doubt as to the nature of the transaction, the absence of such motive is a pertinent circumstance for consideration. It is an essential characteristic of a gift, however, that it be a transfer without consideration. If there is a consideration for the transaction, it is not a gift. 28 C.J. 621. * * *

The court then held, *inter alia,* that the wording of the resolution:

> negatives the idea that a gift was intended; for the distribution was to be made to those who had rendered services to the company; i.e., to those from whom the company had received a consideration in the past. It was to be made as the executive committee might deem wise and proper; i.e., in accordance with the interests of the corporation and the deserts of the persons to be benefited by the distribution. The distribution was thus to be in the nature of a bonus, which "is not a gift or gratuity, but a sum paid for services, or upon a consideration in addition to or in excess of that which would ordinarily be given." Kenicott v. Wayne County, 16 Wall. 452, 471; Payne v. United States, 269 F. 872. * * * And that this interpretation was the one intended is shown by the subsequent action of the corporation in claiming the disbursements made under the resolution as salary deduction from gross income.

The court concluded, finally, that the payment to the officers "was not without consideration, as in case of a gift. The consideration was their previous service to the company * * *" (p. 672).

If the considerations underlying the decision in *Parrott* be looked to, it is a sound decision based on sound grounds. The basis for the decision was essentially that the past services provided the only reason for the payment—*i.e.,* the payments were motivated by the services. Unfortunately, however, in forcing its decision into the mold of contract and property law concepts, taken from *Gray* v. *Barton* and *Corpus Juris,* the court was led virtually to deny the very basis for its own decision—*i.e.,* in its statement that "the motive accompanying a gift is not material." And its assertion that the past services were "consideration" for the payment—which they clearly were not in the contract law sense of a bargained-for exchange creating an enforcible obligation—has led simply to another question-begging formulation. The question is, what causal relationship, short of a contractual obligation, must be established between the services and the payment to justify the legal characterization that the one is "for" the other. And, finally, the reliance on the fact that the corporation deducted the payment provided a ready basis for what is an irrelevant distinction.

Though the actual decision was inherently sound, *Parrott,* because of the failure to express accurately the underlying considerations, failed to be of significant precedential value, as is shown by *Blair* v.

Rosseter, 33 F. 2d 286 (C.A. 9), decided shortly thereafter. There, the president of the Sperry Flour Company was voted at the annual stockholders' meeting $50,000 "as a gift in recognition of" his able services over the past ten years. The corporation charged the payment to surplus and did not deduct it on its tax return. The Board of Tax Appeals said that whether the payment was a gift depended "upon the intention of the parties and the facts and circumstances surrounding the transaction" and found that the resolution was "clear and conclusive" evidence of "the intention to make a gift" (*Rosseter* v. *Commissioner,* 12 B.T.A. 254, 255–256). The court of appeals affirmed, saying (33 F. 2d at pp. 286–287):

> A gift is generally defined as a voluntary transfer of property by one to another, without any consideration or compensation therefor. 28 C.J. 620. The payment here in controversy was denominated a gift by both stockholders and directors; it was without consideration or compensation, and we think it must be conceded that it has all the earmarks of a gift or windfall. The Commissioner seems to contend that there was a consideration for the payment, but manifestly an agreement on the part of a corporation to pay additional compensation to its president for services performed over a period of ten years for which he had already been fully compensated is without consideration and void. Alaska Packers' Ass'n v. Domenico (C.C.A.) 117 F. 99.

To the contention that the case was controlled by *Parrott,* the court said that the cases "have little in

common," since in *Parrott* the corporation "treated the payments as salaries, not as gifts," and deducted them on its tax return (p. 287).

We have tried to show why it is that many decisions of the lower courts have failed to evolve any meaningful standards for determining when a payment is a gift, with a consequent contrariety of results that cannot be reconciled. The basic reason, we believe, is the formulation of the issue as one of "intent," a term which, when divorced from its property law meaning of a purpose to convey title, has no relevant meaning in the income vs. gift context. As we show in our brief in *Duberstein* (pp. 9–12), the only possible substantive content of the term as used by the courts is the desire of the payor that the payment have specified tax consequences, yet the unacceptability of allowing the payor to specify the tax consequences has been vigorously asserted by every court that expressly acknowledged that possible meaning. In short, all would agree that whether a payment is taxable income or an excludible gift should not be controlled by the payor's declaration: "I desire (or do not desire) that this be taxable." The "intent" formulation—and its cousin, the absence of "consideration"[4]—being the source of the difficulty, the

[4] In none of the cases is there "consideration" in the contract law sense of a bargained-for exchange giving rise to an enforcible obligation. Whether the past services are deemed "consideration" for a voluntary payment seems to turn on whether the payment is "intended" to "pay for" the services, with the result that the "intent" test and the "consideration" test are one and the same.

essential first step to giving meaning to the gift definition is to abandon that formulation.

II

GIFTS SHOULD BE DEFINED AS TRANSFERS OF PROPERTY MADE FOR PERSONAL AS DISTINGUISHED FROM BUSINESS REASONS, A DEFINITION FULLY SUPPORTED BY THE STATUTE AND OF SIMPLE APPLICATION

A. INTRODUCTION

1. As we have tried to show in our *Duberstein* brief (pp. 13–15), the only factual distinction that can meaningfully be drawn between different kinds of voluntary payments is the difference in the reasons why they are made, *i.e.,* motive, and it is in terms of that difference, therefore, that any legal distinction must ultimately be made. While at first sight that may seem merely a substitution of one ambiguous word for another, the terms "intent" and "motive," properly used, have very different meanings. "Intent" answers the question "What?"; "motive," the question "Why?" Perhaps the difference most apparent is the difference in the payor's power of choice. "Intent" is an act of will and necessarily implies the power of choice; one can "intend" whatever one wants. That is why, if "intent" were really controlling in these cases, it would have to mean that the payor could "choose" the tax consequences. "Motive," on the other hand, is the inducing cause and is beyond the control of the payor; while the payor is free to decide whether to make the payment, he cannot, by any choice of words, alter the reasons that in

fact caused him to make the decision. In short, "intent" is a matter of choice; "motive," a matter of causation.

Our position is not, it should be emphasized, that "motive" is simply a better test than "intent." It is rather that "intent" is no test at all and that the distinction in "motives" is, as a matter of strict analysis, what actually distinguishes between those voluntary payments which are treated as gifts for tax purposes and those which are not. In none of the cases is there any question about *what* was intended to be given—the property transferred remains the same whether it be a gift or compensation for tax purposes—and the only thing else that can be learned about the transaction is *why* it was given. In short, we urge the "motive" formulation upon the Court not as a matter of preference but as a matter of logical necessity.

Logical necessity, however, carries the inquiry no further than focusing upon motive as the distinguishing fact. The problem remains to define the legal consequences that follow from given motives—*i.e.*, which motives qualify the payment as a gift and which do not. Our purpose in this Point is to answer that question and to show how, from the decided cases and the statute, there can be pieced together a formulation in terms of motive that provides an easily-applied principle to resolve the troublesome gift-income problem.

2. That virtually all the cases have stated the issue as one of "intent" does not mean that, in re-

jecting that formulation, all the learning on the nature of a gift must be rejected. Through the veil of the "intent" language used by the courts are discernible basic underlying considerations which the courts have almost intuitively felt should govern the tax results. The problem is simply to put the elements that can be drawn from the cases together in a new formulation in which their significance is expressly recognized and articulated. We do not mean to imply by that that the results of the cases can be reconciled. To the extent that the particular results turned upon an attempt literally to apply the "intent" test, the results will fall with the test. Our point is simply that, notwithstanding the rejection of the verbal formulation of the cases, and frequently their results, there can still be found guides in the cases for the development of a new formulation put in the more meaningful framework of "motives."

In particular, putting aside the verbal formulation in the cases, we submit that there will be found to be substantial agreement on at least the following propositions:

(1) That the lack of a legal or moral obligation on the part of the "donor" does not by itself make the payment a gift. That proposition is universally accepted. See note 2, *supra*.

(2) That the gift question turns upon some aspect of the payor's action and must be viewed from the payor's, not the payee's, point of view. That of course is the essential assumption of the intent test itself, and is the basic distinction between the "gift" problem and

the "income" problem. By and large, it can be said that the determination whether a payment is a "gift" within § 22(b)(3) must be made from the payor's vantage point; whether it is "income" within § 22(a), from the payee's. The only dichotomy with which we are directly concerned here is between gifts and non-gifts, and from the fact that a payment is not a gift it does not follow *necessarily* (though usually, as here, there is no question about it) that it is income. The distinction of the problems is important to analysis. The fact, for example, that the recipient of a payment has done nothing for it means by itself only that to him it is a "windfall" and raises only the question whether windfalls are income within § 22(a). To determine whether the payment is a gift, as even the intent test assumes, it is necessary to look to what the payor did and why. The few cases—primarily the advertising give-away cases—that look only to what the recipient has done are thus, to the extent that they state the question as one of "gift" rather than "income", inconsistent with the very premise of the great bulk of the "gift" cases (*i.e.*, that it is the donor's intent that controls), and they can better be explained as turning on the "income" question, though without a careful distinction being made between the two problems.[5]

[5] The leading advertising give-away cases were decided before *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, at a time when the view was widely held (based upon the language in *Eisner* v. *Macomber*, 252 U.S. 189, 207) that a pure windfall was not income. Thus the question whether a payment was truly a "gift" or simply a "windfall" was of little significance

3. That payments by an employer to an employee, even though voluntary, ought, by and large, to be taxable. That is evident in the frequently reiterated "presumption" that payments by employers to employees are compensation.

4. That the concept of a gift is inconsistent with the payment being a deductible business expense. That appears in the almost universal reliance (except in the widow bonus cases, where the departure is explicable by their peculiar history [6]) on the fact that the payor deducted the payment as "evidence" that a

and there was little reason for the courts to separate the problems. *Glenn* v. *Bates*, 217 F. 2d 535 (C.A. 6); *Washburn* v. *Commissioner*, 5 T.C. 1333. The post-*Glenshaw* decisions simply followed the earlier ones seemingly without awareness that the holding of *Glenshaw* that windfalls are income made it essential to re-analyze those cases. *Campeau* v. *Commissioner*, 24 T.C. 370; *Fernandez* v. *Fahs*, 144 F. Supp. 630 (S.D. Fla.). The cases are stated at pp. 107-108, *infra*.

[6] The Government bears the primary responsibility. The Treasury Regulations have, since 1918, allowed an employer to deduct reasonable payments to a deceased employee's widow. *E.g.*, Regs. 94, § 23(a)-9; Regs. 118, § 39.23(a)-9; Regulations under the Internal Revenue Code of 1954, § 1.404(a)-12. In 1939, the Commissioner issued a ruling that such payments were not only deductible but were gifts to the widow, since allowances "paid by an organization to which the recipient has rendered no services" are gifts. I.T. 3329, 1939-2 Cum. Bull. 153. The first "widow-bonus" case, *Aprill* v. *Commissioner*, 13 T.C. 707, arose while that ruling was still outstanding. There the widow of the president of a corporation, having herself inherited his 75% of the stock and become president and a director, joined with the other two directors in voting herself $36,000 "in recognition of the services" rendered by her late husband, which payment the corporation deducted. The Tax Court took the Commissioner at his word and found that the corporation, having followed I.T. 3329 to the letter, "intended" a gift; the deduction was not contrary evidence since the I.T. allowed it. Shortly there-

gift was not "intended"—a fact the probative value of which, if any, depends upon an assumption of mutual inconsistency.

5. That a gift involves such personal elements as affection, good will, regard, or sympathy, and a purely "business" transaction ought not be exempt as a gift. Although difficult to fit into the "intent" rationale (other than by such an awkward formulation as an intent "to show" those feelings), mention of such elements appears frequently in the lower court cases and, as we shall show, almost invariably in this Court's decisions.

6. That a business corporation cannot properly make a "gift" of its assets. Although difficult to square with the "intent" formulation—there is no reason why a corporation, having decided to make a payment for proper corporate *reasons*, cannot *intend* it in such a way as to lessen the recipient's tax burden and thus make a smaller payment serve the same

---

after, the Commissioner revoked I.T. 3329, pointing out that it had misconstrued a provision of the regulations treating as a gift a payment made "by one *to whom* no services have been rendered" (Regs. 111, § 29.22(a)-2), under which it was irrelevant *by whom* the services were rendered. I.T. 4027, 1950-2 Cum. Bull. 9. When the new I.T. got to the Tax Court, however, the court simply relied upon its prior decisions as controlling precedents, noting that the Commissioner "cannot by administrative ruling tax as ordinary income a payment which the payor made and intended as a gift." *Hellstrom* v. *Commissioner*, 24 T.C. 916 ($33,600 paid to 35% stockholding widow of president). The *Hellstrom* decision, in turn, has provided the pattern for all the other widow-bonus cases. The cases are stated at pp. 103-107, *infra*.

Apart from the widow-bonus cases, the only decision that seems to accept the view that a deductible payment can be a gift is *Peters* v. *Smith*, 221 F. 2d 721, 725 n. 3 (C.A. 3), *infra*, pp. 101-102.

purpose—that view has been relied upon, as we shall show (*infra*, pp. 44–48), in over twenty decisions and has never been expressly challenged.

It is, we believe, unnecessary to add anything to those established ingredients in order to develop a sound principle for distinguishing between gifts and non-gifts. It is necessary only to provide for them a meaningful framework and explicitly to rationalize their relevance in terms of the statutory purpose.

We will begin the analysis in reverse order, simply asserting at the outset the definition of gifts that we propose and then showing how that definition conforms to the felt concepts of the decided cases and is directly supported by statute. We will show, finally, how the application of that definition will rarely involve any disputed issue of fact and will almost automatically dispose of the great bulk of the "gift" cases.

B. A GIFT MAY BE DEFINED AS A TRANSFER OF PROPERTY MOTIVATED BY PERSONAL, AS DISTINGUISHED FROM BUSINESS, REASONS

The correct definition of a gift, we submit, is a transfer of property motivated by personal, as distinguished from business, reasons. Since we include within "personal" reasons everything that is not comprehended by "business" reasons, the controlling definition is that of "business" reasons. We shall begin, however, by showing affirmatively the necessarily broad and undefinable scope of "personal" reasons, and then define "business" reasons.

1. The concept of a gift most frequently alluded to in the cases is that of a manifestation of a free and

unrestrained generosity induced by such motivations as affection, compassion, altruism and the like. The idea, however, is necessarily broader than that, and can be limited neither to free-flowing generosity nor to "good" motivations. It is apparent that many admitted gifts are prompted less by a freely-formed "desire" than by a sense of duty, perhaps enforced by social pressures—*e.g.,* a duty to one's family (providing for a disliked but needy relative), a duty to society (contributing annually to charity), or a duty to God (tithes). It must be acknowledged also that gifts can be made for quite unworthy motives—*e.g.,* hate, spite, lust, vindictiveness, or self-aggrandizement. Ultimately, the only thing that such motives have in common is not their quality but the fact that they are "personal" to the payor in the sense that they arise, not from his income-producing activities, but from his "personal" relationship as a human being to his family, to his fellows, to his community, to his country, or to God. In the end, we submit, what is "personal" can usefully be defined only as that which has no relation (or no sufficient relation) to "business" activities. In short, "personal" reasons are those which are not "business" reasons.

2. By "business" reasons we mean any reason that establishes a "proximate" (an admittedly vague word that requires separate development, see pp. 31–32, 59–62, *infra*) causal relationship between the payment and the conduct of a business, the production of income, or the performance of services (*i.e.,* any "tax-significant" transaction). The definition does not require that the

payment be made for an anticipated benefit; it is enough that it be related to a past benefit. Suppose, for example, that an employer makes a payment to a retired employee or an employee's widow. It is not, under our definition, necessary to show that he did so to stimulate the good will of other employees or to obtain any other prospective benefit, or even that he felt that the employee had not been fully and fairly paid. It is enough if he was moved simply by the sense that it is fair and just that an employer, having reaped the benefits of the employee's productive years, should make some provision for the employee's old age or for his dependents. That is a sense of "obligation"—or "propriety," to avoid any restrictive meaning—the employer feels only because of the employment relationship and provides a direct causal relationship between the receipt of the services and the payment.

The troublesome point in the definition, of course, is what is meant by "proximate." Some such qualification must be made, however, to exclude, for example, the contribution made by a lawyer to a community venture with the hope that the attendant publicity will stimulate the payor's law business, or the kind of emotional response to the performance of services that we suggested in our brief in *Duberstein* (p. 17, n. 10). See also pp. 59–62, *infra*. The concept can be given concreteness, however, by identifying it with the more familiar concepts of business accounting. When the employee-pension case, for example, is put in the context of partnership, trust, or corporation accounting, the answer is immediately evident that it could properly

be treated as a "cost" of the business to be paid out of the business assets rather than out of the "personal" funds of the partner, the trustee, or the president. It is essentially that kind of relationship to the business we mean to imply by "business" reasons.

The standard can be given its greatest concreteness, however, simply by relating it to that already-established body of law defining the degree of relationship to the business necessary to justify a "business expense" deduction. That is, if the payment is sufficiently related to the business or the performance of services to be a proper charge against the business profits for tax purposes (if the other requirements for a business deduction are met), then it ought to be deemed to be sufficiently related not to qualify as a gift. The only aspect of the business expense definition that is relevant, of course, is that defining the necessary degree of relationship of the expenditure to the production of income. Since there may be other reasons why a deduction would not be allowable—*e.g.*, the payor is exempt or is not in a trade or business, or the payment is excessive—the question does not turn on whether the particular payment was deductible. And, of course, the *fact* that the payor did or did not claim a deduction ought have no more significance than it does when the deduction itself is challenged. The only relevance of the law of business expenses, in short, is that the same standards of business relationship should be applied for both purposes.

3. There is, we think, nothing novel about this definition of gifts other than the explicit rejection of the

futile search for "intent." It conforms fully to, and satisfies in precise degree, the felt considerations that we believe have influenced the courts, albeit through the barrier of the language of intent, in reaching decisions. The definition does not depend upon the existence of a legal or moral obligation; it does turn upon some aspect of the payor's conduct, through motive rather than intent; it articulates the causal relationship between services and payment that precludes a gift; it gives effect to the felt inconsistency of a deductible payment being a gift, but does so by making the definitions mutually exclusive rather than by giving the fact of deduction evidentiary value; it makes decisive the distinction between "personal" and "business" relationships suggested by such terms as affection, regard, or generosity, though it defines "personal" motives more comprehensively; and finally, as we shall develop in more detail below (pp. 40–56), it provides a tax definition of gifts that conforms to the reiterated view that a corporation cannot (though with some qualification) make a gift. In short, it gives effect to all the substantial underlying considerations that one may discern from the decided cases, save only those elements peculiar to the "intent" test (the relevance of what the payor calls the payment, the fact that he deducted it, etc.) and those which confuse the "gift" issue and the "income" issue (the significance of the fact the payee performed no services). It remains to be seen only whether that definition can be supported by the statute; provides a workable principle; and can be reconciled with the decisions of this Court.

C. THE SUGGESTED DEFINITION OF GIFTS IS FULLY SUPPORTED, IF NOT REQUIRED BY STATUTE

The suggested definition of gifts as transfers made for "personal" reasons, defined to exclude "business" reasons in the same sense that that term is used for deduction purposes, is, we believe, fully supported by the provisions of the Code dealing expressly with the tax treatment of gifts—namely, the exclusion provision and the provisions defining the basis of property acquired by gift. Those provisions, we think, have a double impact. They show not only that Congress thought of gifts as essentially family or "personal" transfers, but they make clear that Congress could not have intended to exempt as gifts payments of a kind that would be deductible by the payor.

1. That Congress thought of gifts as personally-motivated transfers is evident, we submit, from no more than its assimilation of gifts to transfers at death. Section 22(b)(3) excludes from income "property acquired by gift, bequest, devise, or inheritance." Bequests, devises, and inheritances, it is obvious, involve primarily intra-family transfers of wealth; and even extended beyond blood lines, as the exclusion of course must be, they are dispositions made for uniquely "personal" reasons. In excluding such transfers at death from income, it was necessary, to be consistent, to exclude the same kind of transfers when accomplished *inter vivos*. Thus from the exemption of "gifts" there is no reason to think that Congress had in mind any types of transfers essentially different in kind from bequests. To the contrary, from the fact that gifts were included in the same category

as transfers at death—literally, in fact, "gift, bequest, devise, or inheritance" are enumerated simply as alternative mechanisms "by" which property is acquired—it ought to be inferred that the sole purpose was to avoid discrimination against *inter vivos* transfers of like character, and not to permit a whole range of "business" transfers to escape taxation. In short, the exclusion of gifts should be limited to *inter vivos* transfers serving the same function and made for the same reasons as transfers at death—namely, those made for uniquely "personal" reasons.

Support for that inference can also be drawn from the interrelationship of the income, gift, and estate taxes. The exemption of gifts *inter vivos* or at death from the income tax reflects a judgment that such essentially intra-family transfers of wealth ought to be taxed under a special scheme tailored to such transfers (the gift and estate taxes) rather than be subjected to the general income tax. Corporations, however, have never been subject to the gift tax, and the explanation must be either that Congress was wide of the mark in the attempt to correlate the two systems of tax—leaving a great class of transfers subject neither to the income tax nor the gift tax—or that it thought of gifts as transfers being made for such "personal" reasons that a corporation could not make a gift. The explanation given by Congress was the latter; it explained the limitation of the gift tax to individuals on the ground that a gift "by a corporation * * * would constitute a gift from the stockholders of the corporation." H. Rep. 708, 72d Cong., 1st Sess., pp. 27–28; S. Rep. 665, 72d Cong., 1st

Sess., p. 39. Since corporations obviously can make voluntary payments in their own behalf for business reasons, and the only thing they lack is "personal" motivation, the necessary assumption of Congress was that payments made for business reasons are not "gifts".[7]

2. Even clearer, we think, is the evidence that Congress did not intend to exclude as gifts payments of a kind that would be deductible by the payor—that is, that "gifts" must be defined in a way that excludes deductible business expenses.

The effect of a non-exclusive definition of gifts and business expenses, it is clear, would be to allow what would otherwise be taxable income (*i.e.*, but for the transfer from one taxpayer to another) to escape taxation altogether. A deductible payment, since it reduces the income otherwise taxable to the payor, in effect comes "out of" of the payor's income. If, in turn, the payment is treated as a "gift" to the payee, the result is that the income is taxable neither to the payor nor to the payee. That is, simply by virtue of the payment from one taxpayer to another, the total income taxable to the two taxpayers is reduced by the full amount of the payment.

The justification for exempting gifts and devises from the income tax may be mooted, but surely at least one element of the policy is the idea that such tranfers result only in the shifting, not the augmentation, of wealth and thus do not constitute "income" in

[7] Even so, the statement that a corporation cannot make a gift other than on behalf of its stockholders must be somewhat qualified (see pp. 50–56, *infra*).

the economic sense. That leads, however, only to the conclusion that such a transfer ought not be treated as an "income-creating" transaction, and a construction of the exclusion that permits it to be used to destroy what would *otherwise* be taxable income corrupts its basic purpose. We are not left, however, with that general policy inference, for there are two specific provisions that make clear Congress' concern that income not be allowed to escape taxation by means of the exclusion.

a. Section 22(b)(3) does not stop with the sentence excluding gifts and devises from income; it goes on to provide:

> * * * There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. * * *

That provision was, of course, specifically concerned with such transfers as a gift of an income interest in a trust, and we do not contend that a deductible gift would be a gift "of income" within the literal meaning of that provision. A deductible gift obtains its "income" characterization only by virtue of its deduction from the payor's income and is not intrinsically a gift of an "income" item in the sense Congress had in mind. It is evident, however, that a deductible gift produces precisely the same substantive evil as would a nontaxable gift "of income"—the disappearance of income as the result of the gift. We cannot believe that Congress intended to allow by the first sentence of the section a result that it so as-

siduously sought to avoid in the second. The two sentences can be reconciled in purpose only by defining gifts as excluding business expenses.

b. The second provision that shows Congress' concern that the gift exclusion not be a valve through which otherwise taxable income can escape taxation is § 113(a)(2), which gives to property acquired by gift the same basis in the hands of the donee that it had in the hands of the donor (with an exception not here relevant). The effect is to assure that any unrealized appreciation in the value of the property on the date of the gift does not escape taxation by virtue of the gift but will ultimately be taxed to the donee upon his realization of it by a sale or exchange. Like the second sentence of § 22(b)(3), § 113(a)(2) makes clear the purpose of Congress to follow all "income" even through what is admittedly a gift transaction. If, while at pains to prevent even unrealized appreciation in a capital asset from escaping taxation by means of gift, Congress intended to allow deductible payments, in effect coming "out of" the ordinary business profits of the payor, to be excluded from the payee's income, it closed the windows but left open the door.

There is more than a mere policy inconsistency, however, between § 113(a)(2) and a definition of gifts that includes deductible payments. It can be shown, we think, that there is an irreconcilable logical inconsistency. Suppose that an employer buys a bearer bond for $100 and makes a "gift" of it to an employee's widow, deducting the cost as a business expense, and that the widow immediately sells it for $100. Assuming that the transfer was a true "gift" within

§ 22(b)(3), is it not clear that the widow is nevertheless fully taxable on a $100 gain? She is required to take her donor's basis (§ 113(a)(2)), with all "adjustments" required for the period during which the property was held either by her or by her donor (§ 113(b)(2)). Her donor's basis was originally $100, but he deducted that cost as a business expense when he gave the property to her, and that deduction requires an adjustment to basis (see § 113(b)(1)(A))—the very purpose of the basis-adjustment provisions is to prevent the same cost from being recovered tax-free more than once. Hence, her basis is zero, and upon the sale of the bond she realizes a fully taxable gain of $100, being entitled to no capital gains deduction because the property was not held for six months. In short, the result of a deductible "gift", if the payee immediately "realizes" its value, is precisely the same as if it were not a gift but were itself treated as a taxable receipt!

But now suppose precisely the same transaction, except that the purchase and sale of the bearer bond is omitted, the widow simply being given the dollars to begin with. Surely there is no logical basis for the two transactions having different results—the parties have simply spared themselves the trouble of the washing-out purchase and sale of the bond. To be consistent, therefore, we would have to treat the dollars received by the widow as zero-basis dollars—their "basis" having been fully recovered by the payor's deduction—the face value of which is immediately "realized" upon receipt, producing a "gain" of $100 which, since money is not a capital asset, is fully taxable regardless of the holding period. The effect, in

short, is that the "gift", though treated as a true gift, becomes a gift "of income", the dollars having been converted into an "income item" by virtue of their deduction. We grant the conceptual difficulties in that analysis—since money is ordinarily fully "realized" and accounted for at face value immediately upon receipt or disbursement, it rarely, if ever, has a basis different from its face value (or, what amounts to the same thing, it is seldom necessary to assign it a "basis")—but it demonstrates, we believe, the logical inconsistency inherent in the concept of a deductible "gift." The treatment of a deductible payment as an excludible "gift" simply cannot be rationalized with the underlying presuppositions of the other provisions of the Code governing the effects of gifts. If "gifts" are defined as including deductible payments, the exclusion and the donee-basis provisions work at cross-purposes, the one permitting income to escape taxation and the other being designed to prevent that very result. It is only by defining gifts so as to exclude any payment made for a "business" reason, and hence potentially deductible, that the several provisions can be made to work together.

D. SINCE THE FUNDS OF A CORPORATION ORDINARILY CANNOT PROPERLY BE EXPENDED FOR THE SORT OF PERSONAL REASONS ESSENTIAL TO A GIFT, THE PRESUMPTION THAT THE DIRECTORS DID NOT COMMIT A BREACH OF TRUST ORDINARILY RESOLVES THE QUESTION OF FACT WHETHER A CORPORATE PAYMENT WAS MADE FOR PERSONAL REASONS

1. The lower courts have frequently said, though without specification of the kind of evidentiary fact

upon which the result turns, that whether a payment is a gift is a "question of fact." The treatment of the question as one of fact is a function, we believe, of the failure specifically to say what a gift is and the reliance on the essentially question-begging formulation that a payment is a gift if it was "intended" as a "gift." Our purpose in this section is to show that, once a gift has been clearly defined as a payment made for personal rather than business reasons, the basic fact upon which the definition turns—"Why was the payment made?"—will almost never be a matter of dispute.

The explanation is that virtually all the litigated cases have involved payments by corporations or similar entities, and in such cases the reason for the payment is established simply by the presumption that the officers or directors did not commit a breach of trust by distributing corporate assets for an improper reason. That presumption establishes *prima facie* that the payment was made for a reason—usually readily identifiable—for which the use of corporate funds would have been proper, and it is rare indeed that a recipient of a voluntary payment would undertake to challenge that presumption by proving, or even alleging, that the officers acted for a reason that would make the payment a breach of trust. In short, in almost every case, that reason which justifies the use of corporate funds must be accepted as the reason for which the payment was made, and there remains no factual issue to be resolved.

The presumption of the propriety of corporate acts only answers the factual question of why the pay-

ment was made. When the reason for the payment has been thus determined, there remains a logically separate step of applying the tax definition of gifts to that reason to determine whether the payment qualifies as a gift. The cases have generally not separated the two questions but have assumed that the corporation law rule that corporate officers cannot make "gifts" of corporate property—and should therefore be presumed not to have done so—answered the tax question. That assumes that the corporation law definition of "gifts" is the same as the tax definition—or, more precisely, that any proper corporate reason for a payment would necessarily be a "business" reason precluding its characterization as a gift for tax purposes. By and large, that is true, and in the context in which the statements were made—payments to officers or employees—we think the equivalence is self-evident. As we shall point out, however, there are some kinds of payments a corporation can make for other than "business" reasons in the tax sense, and the statement that a corporation can never make a gift for tax purposes requires some qualification. The cases to be discussed, therefore, should be read in the light of their context—payments to officers or employees—and not as stating an unfailing universal rule necessarily governing in other contexts.

So qualified, however, the cases establish three propositions which, when their implications are fully appreciated, would resolve virtually every one of the gift-income cases that have been thus far been litigated: (1) that corporate assets can properly be given to an officer or employee only for business reasons;

(2) that payments made to an officer or employee must be presumed to have been given for such reasons rather than by a breach of trust; and (3) that payments made for such reasons are not gifts for federal tax purposes. Those propositions would be equally applicable, of course, to payments to members of the officer's or employee's family (as in the widow-bonus cases) or to a business associate (as in *Duberstein*). If those propositions be accepted, therefore, the tax treatment of corporate payments to such persons would raise a question of fact only in that rare case in which the recipient contended, rather ungraciously,[8] that the officers, directors, or majority stockholders[9] had violated their duty of loyalty and made use of the corporate assets for their own personal purposes, namely, to enrich an object of their bounty. In the absence of such a contention, the payments would not be gifts as a matter of law.

[8] Nor is that a matter only of taste, for proof that the corporate officer or stockholder had used corporate funds to make a personal gift, while exempting the recipient from tax, would mean that the officer was himself taxable on the moneys so appropriated by him to his own use (either as compensation, a dividend, or misappropriated funds, as the circumstances might warrant). In effect, the officer would be treated as having constructively received a distribution from the corporation of which he had then made a gift to the recipient. *Union Stock Farms* v. *Commissioner*, 265 F. 2d 712, 724-725 (C.A. 9); *Jolly's Motor Livery Co.* v. *Commissioner*, 1957 P-H Tax Ct. Mem. ¶57,231; *Lasker* v. *Commissioner*, 1952 P-H Tax Ct. Mem. ¶52,012; *Reichert* v. *Commissioner*, 19 T.C. 1027; see *Nelson* v. *Commissioner*, 203 F. 2d 1 (C.A. 6); cf. *Helvering* v. *Horst*, 311 U.S. 112.

[9] As to unanimous action by the stockholders, see pp. 48-50, *infra*.

543845—60——4

2. It is, of course, firmly established as a matter of corporation law that in general neither the officers, the directors, nor the stockholders have authority to make gifts of corporate funds. As this Court, in holding that excessive bonuses paid corporate officers would constitute an actionable waste of corporate assets, stated in *Rogers* v. *Hill,* 289 U.S. 582, 591-592:

> * * * The dissenting opinion of Judge Swan indicates the applicable rule: "If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part and the majority stockholders have no power to give away corporate property against the protest of the minority." 60 F. (2d) 109, 113. * * *

New York, the domicile of the payor both here and in *Duberstein,* follows the general rule. *E.g., Worthington* v. *Worthington,* 100 App. Div. 332, 91 N.Y. Supp. 443 (1st Dept.); *Holst* v. *New York Stock Exchange,* 252 App. Div. 233, 299 N.Y. Supp. 255 (3d Dept.); *Chadwick* v. *New York Stock Exchange,* 252 App. Div. 714, 299 N.Y. Supp. 256 (3d Dept.); see also, *Moore* v. *Keystone Macaroni Mfg. Co.,* 370 Pa. 172, 87 A. 2d 295.

The significance to the tax problem of the lack of corporate capacity to make gifts and of the presumption of the regularity of corporate acts was acknowledged at an early date (see *Parrott* v. *Commissioner,* 1 B.T.A. 1) and has never been expressly denied. The leading case is *Noel* v. *Parrott,* 15 F. 2d 669, 671

(C.A. 4), where, in holding taxable a "gratuitous appropriation" to corporate officers authorized by the board of directors, the court said:

> * * * It needs neither argument nor citation of authority to establish the proposition that the directors were without authority to give away the corporate assets, and that for them to make to several of their members and other persons a gift of a large sum of money from the corporate assets * * * would amount to an illegal misapplication of corporate funds. We must assume that the directors did not intend such a flagrant violation of their trust. * * *

The premise of the rule was explained by the Third Circuit: "The corporate 'person' may be deemed by a fiction of the law to have abilities normally ascribed to man but that fiction cannot be indulged to the extent of endowing the corporation with feelings of love and affection for its stockholders, officers and directors." *Chandler* v. *Commissioner,* 119 F. 2d 623, 627–628. And in another case, in holding that a corporation's payment of the premiums on a life insurance policy in favor of an officer's wife and children was compensation to the officer, the Third Circuit found it unnecessary to consider any other facts or to say more than that the payments "must be presumed as compensation for services, rather than gifts * * * since a corporation cannot lawfully give away its assets." *Yuengling* v. *Commissioner,* 69 F. 2d 971, 972. The rule has been relied upon no fewer than eleven times

by the Tax Court,[10] and has been endorsed by not only the Third and Fourth, and perhaps the Sixth,[11] but the Second, Eighth, Ninth, and District of Columbia Circuits, as well as by a district court in the First Circuit.[12] And in every case in which the principle was relied upon, the claim that the payment was a gift was rejected.

---

[10] *Parrott* v. *Commissioner*, 1 B.T.A. 1; *Beatty's Estate* v. *Commissioner*, 7 B.T.A. 726; *Garey* v. *Commissioner*, 16 B.T.A. 274; *Landon* v. *Commissioner*, 16 B.T.A. 907; *Binger* v. *Commissioner*, 22 B.T.A. 111; *Wilcox* v. *Commissioner*, 27 B.T.A. 580; *Anderson* v. *Commissioner*, 31 B.T.A. 197; *Van Sicklen* v. *Commissioner*, 33 B.T.A. 544; *Walker* v. *Commissioner*, 25 T.C. 832; *Jackson* v. *Commissioner*, 25 T.C. 1106; and *Silverman* v. *Commissioner*, 28 T.C. 1061.

[11] In *Lunsford* v. *Commissioner*, 62 F. 2d 740 (C.A. 6), the court held that a $50,000 "momento" given by a corporation, after a sale of its assets to another corporation, to the officer of the buying corporation with whom it had negotiated the sale was not taxable. It reasoned that since the recipient had performed no services for the payor, the authority of the officers of the payor to make the payment was irrelevant: the payment could not be compensation in any event, and if it was unauthorized it was subject to being recovered by the stockholders and thus not a gain. Those premises have of course since been definitively rejected—a gain is income whether or not it is compensation (*Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426) and whether or not there may be a potential liability to repay it (*United States* v. *Lewis*, 340 U.S. 590; *Rutkin* v. *United States*, 343 U.S. 130)—and the opinion is now perhaps most significant for its implicit acknowledgment of the principle that a corporation cannot make a gift to an employee.

[12] *Fisher* v. *Commissioner*, 59 F. 2d 192 (C.A. 2); *Commissioner* v. *Bonwit*, 87 F. 2d 764 (C.A. 2); *Fitch* v. *Helvering*, 70 F. 2d 583 (C.A. 8); *Botchford* v. *Commissioner*, 81 F. 2d 914 (C.A. 9); *Levey* v. *Helvering*, 68 F. 2d 401 (C.A. D.C.); *Brayton* v. *Welch*, 39 F. Supp. 537 (D. Mass.); cf. *Capitol Coal Corp.* v. *Commissioner*, 250 F. 2d 361 (C.A. 2).

In the face of that seeming unanimity, it may be wondered how so many payments by corporations to officers or their widows have in fact been held to be gifts. The answer is that the cases holding corporate payments to be gifts simply do not mention the question of corporate authority. There is not a single case, to our knowledge, that expressly takes issue with the statement in *Noel* v. *Parrott* and the twenty-odd cases following it that corporate officers and directors *cannot* make gifts of corporate assets to benefit the officers and employees and must be presumed not to have committed a breach of trust by doing so.[13] The principle, in short, is one which has never been challenged, which seems to be conclusive when invoked, which is unanswerable in its force, but which is simply

[13] The only case we have found holding a corporate payment to be a gift that seems even to acknowledge that there might be such an issue is the *per curiam* opinion in *United States* v. *Bankston*, 254 F. 2d 641, 642 (C.A. 6), in which appears this single sentence touching on the problem: "It has been held that a corporation may make a gift. *Bogardus* v. *Commissioner*, 302 U.S. 34; *Richards* v. *Commissioner*, 111 F. 2d 376 (C.A. 5)." In *Bogardus*, as we shall show (*infra*, pp. 68-77), the Court treated the payment as having been made by the stockholders in their individual capacity, not by the corporation (the implication being that the payments were dividends to the stockholders of which they then made gifts to the ultimate recipients). In any event, *Bogardus* contains no mention of the corporate authority question. In *Richards*, the court simply held, without explanation, that the rental value of a home owned and maintained by a corporation and occupied by its sole stockholders, husband and wife, was a "gift" to them. The only mention of the corporate authority issue is to be found in Judge Sibley's dissent, which noted that, while family transfers might be presumed to be gifts, "A corporation has no * * * relatives" (111 F. 2d at 377).

ignored when another result is sought to be justified. All that is required, we believe, to resolve the seemingly insoluble gift-income problem, at least in the area of its major importance (payments by corporations and similar entities to officers and employees and their families), is to give to that fully-established and unchallenged, but frequently overlooked, principle its full scope: Except where the taxpayer affirmatively undertakes to show the contrary, the presumption is that the payment was *not* a misuse of corporate assets, that it was made to further the business interests of the corporation and not to satisfy the personal feelings or desires of the directors or officers who approved the payment, and hence is not a gift.

To round out the analysis, one other point should be made. Some of the cases cited above assumed that the incapacity of the corporation to make such a gift was a problem only of a lack of authority in the officers or directors which would have been overcome if the payment had been authorized or ratified by the stockholders, and at least one case in which there had been stockholder approval expressly distinguished *Noel* v. *Parrott* on that ground.[14] As *Rogers* v. *Hill* makes clear, however, the problem goes deeper than that, and it is equally true that a majority of the stockholders cannot properly authorize a use of corporate assets for other than business reasons. If

---

[14] *Blair* v. *Rosseter*, 33 F. 2d 286 (C.A. 9); see also *Cunningham* v. *Commissioner*, 67 F. 2d 205 (C.A. 3), in which the court relied upon the action of the directors in seeking stockholder approval of a payment as affirmative "evidence" that it was a gift.

the payment were approved by the stockholders unanimously, however, it would ordinarily be a matter of no concern to the state law—unless of course creditors were prejudiced—for what reason the payment was made, and in such a case the presumption that the payment was made for business reasons, because otherwise it would be a breach of trust, might not be available.[15] If, however, the payment was not made for a business reason but solely for reasons personal to the stockholders, at their instance and with their approval, the corporation would be acting, not for itself, but simply as an agent for the stockholders, distributing to the object of their bounty moneys that would otherwise be available to the stockholders as dividends. However such a transaction might be treated for state purposes, for federal tax purposes it would seem clearly to be a constructive dividend

---

[15] In *Blair* v. *Rosseter*, *supra*, note 14, the resolution making a $50,000 "gift" to the president of the Sperry Flour Co. "in appreciation of" his able services was said to have been "unanimously" voted at the annual stockholders' meeting. That probably meant, however, only that all those represented at the meeting approved the resolution, and if in fact there was no business justification for the payment (though there clearly was) the stockholders present (or those voting general proxies) were guilty of a gross breach of duty to those absent. And even if all the stockholders were in fact present, so that there was no breach of trust element, ought it not nevertheless be presumed in the absence of special circumstances (see note 17, *infra*) that, when acting as a unit to approve or ratify corporate action, the stockholders act in the interests of the corporation (*i.e.*, for business reasons) and not as individuals serving their personal interests, particularly since they are not likely to be moved by the same "personal" desires unless it is a family corporation.

to the stockholders and a gift by them to the recipient,[16] the corporation having been instructed, in effect, simply to pay the dividends to the stockholders' nominee. Cf. *Bogardus* v. *Commissioner*, 302 U.S. 34, discussed *infra*, pp. 68–77. Thus for a recipient to undertake to show that a stockholder-approved payment was made to him not for business reasons but for the personal reasons of the stockholders, so that the payment is a nontaxable gift to him, he would have to show, in effect, that the payment was a dividend taxable to his benefactors.[17]

3. We noted at the outset of this discussion that the statements in the cases that a corporation cannot make a gift, although accurate enough as a general principle and unquestionably true in the context in which they were made (payments to officers or employees), required some qualification. The obvious exception, of course, is that of charitable corporations making distributions to the objects of the founder's or contributors' charity (not, however, to their own employees), but there are also exceptions even in the case of business corporations.

The question turns on what capacities are attributed to a business corporation. Under the traditional view of a corporation as serving solely its stockholders' economic interests, the officers—while having

---

[16] See cases cited in note 8, *supra*.

[17] Such a contention is more likely to come, if at all, from the Commissioner, and where the payment is made by a family corporation to a natural object of the family's bounty—which is typical of the widow-bonus cases (see pp. 103–107, *infra*)—it seems not an unreasonable claim.

some freedom, in conformity with enlightened business practices, to go beyond the law of contracts to deal fairly and equitably with those who contributed to the business—ultimately were required to justify every expenditure by its direct relationship to the profit-making function of the corporation. Today, however, it is becoming increasingly recognized that a corporation has responsibilities to society as well as, and independent of, its responsibilities to its stockholders. See, *e.g.*, *A. P. Smith Mfg. Co.* v. *Barlow*, 13 N.J. 145, 98 A. 2d 581. In effect, the corporation has to that extent been personified and made, as it were, a "citizen" of society expected, in return for the benefits conferred upon it by society, to share the burdens of society. Since that is a responsibility that devolves upon a corporation simply as a member of society, rather than arising out of its profit-making activities as such, it is no less a "personal" responsibility, as we have defined the term, than that assumed by an individual. And, in turn, just as a payment made by an individual in recognition of that responsibility is a gift, so ought one made by a corporation be treated as a gift.

The most common manifestation of the felt social or community responsibility of a corporation is, of course, the charitable contribution to a tax-exempt organization, but other "public-responsibility" payments could equally be made to non-tax-exempt recipients and there the excludibility of the payment under § 22(b)(3) would become significant. The only limitation upon the treatment of such payments as

gifts for tax purposes is that imposed by the exclusion from the gift definition of payments made for "business" reasons, which we have defined as the same relationship to the business that is necessary to justify a business expense deduction. In short, to the extent that it is recognized for tax purposes that a corporation has independent social obligations "personal" to it for gift exclusion purposes, its expenditures for those purposes must be treated in the same degree as nondeductible "personal" expenses. The one thing that is plain from the statute, we believe, is that there can be no such thing as a business-expense deductible "gift."

However, recognition that a corporation may make "gifts" in exercise of its public responsibility in no way impairs the premises of the conclusion that a corporation cannot make gifts to its officers, employees, business associates, or their families—namely, that it lacks the capacity for the only motivations out of which gifts to such persons could be made (affection, pity, compassion, admiration, etc.) and such payments can be justified, if at all, only as a recognition of a responsibility arising out of their (or their deceased husbands') performance of services. One can, by a play of words, say that a corporation has a "social responsibility" to provide for employees in their old age, or for their dependents, but it is patent that that is a responsibility devolving upon it, not as a member of society at large, but only because of the performance of services for it. And that which is paid because of the performance of services is no

less compensation, nor more a gift, because the employer follows enlightened business practices not imposed upon it by the law of contracts. What is decisive is that the payment is made because of services—and that precludes the characterization of gift, whether the employer is an individual entrepreneur, partnership, corporation, or other entity.

4. A final note should be added to clarify the respective scope of federal and state law in dealing with payments by corporations. By and large, the general state law of corporate powers seems to conform with our definition of gifts, in the sense that, with the exception of the "social responsibility" kind of payments, state law does not authorize the use of corporate assets for any reason that would qualify as a "gift reason" within the tax definition. Thus it is generally true, subject to the one exception, that no payment properly made by a business corporation can be a gift. That, however, is due only to the coincidence of the federal and state definitions, and it is ultimately federal law that is controlling.

If the several steps of analysis are separated, it is clear that, in the end, state law is relevant only for the aid it gives in determining the facts. Because of the presumption of the regularity of corporate acts, we can answer the factual question "Why was the payment made?" by asking the legal question "On what basis could the use of corporate funds be justified?", and the answer to that question can be accepted as the reason for the payment in the absence of the rare claim that the payment was in fact made for an improper reason.

Once the reason for payment has been determined, however, the function of state law is at an end, and there remain not one but two federal questions. The first, of course, is whether the ascertained reason for the payment is a "gift reason" within the federal definition. If it were concluded that the payment was made for a business reason and is taxable to the recipient, that would ordinarily be the end of the matter. But if it were found that the payment was made for a "personal" reason and was a nontaxable gift to the recipient, there would also be a second federal question—namely, the application of the income-attribution rules. Suppose, for example, it were found that the president of a corporation had directed a payment to be made to his son, not because of any services performed by the son, but only because of his familial affection for the son. While that would establish that the son received the payment as a gift, under the income-attribution rules it would be treated as a taxable distribution to the father of which he had made a gift to the son—*i.e.*, the transaction would be essentially an assignment of income by the father.[18] That result is easy, of course, if under state law the payment amounted to a misappropriation of corporate funds by the father (or could be justified only by treating it as compensation or a dividend to the father), but it would equally follow, we submit, even if a charter provision valid under state law had purported to authorize the "corporation" to make gifts to persons designated by the president. In short,

[18] See note 8, *supra*.

the tax law is not bound to give to a corporation as a separate tax entity all the capacities ascribed to it by state law, and a payment treated by state law as having been made by a corporation in its own behalf can be treated for federal tax purposes as having been made by it in behalf of another to whom should be attributed a constructive receipt of the payment. Ultimately, therefore, the capacities to be attributed to a corporation for tax purposes is a question of federal law. That is true even in the case of gifts made by a corporation in recognition of its social responsibilities. The tax question is not answered solely by the fact that state law permits the corporation so to use its assets; the federal rule *could* be that a corporation is recognized for tax purposes only in its business capacity and *any* gift made by it is to be treated as being made on behalf of the individual stockholders who ultimately control the corporation.[19] Thus to treat a socially-motivated payment by a corporation as a gift by the corporation in its separate capacity, and not on account of the stockholders, requires a rule of federal law recognizing that a corporation has social responsibilities "personal" to itself. Thus, if a state should undertake to endow a corporation not only with a social responsibility but with the capacities of affection, pity, admiration, and the

---

[19] When the gift tax was adopted, the reason given for applying it only to gifts by individuals, as we have noted earlier, was that a gift "by a corporation * * * would constitute a gift from the stockholders of the corporation." H. Rep. 708, 72d Cong., 1st Sess., pp. 27–28; S. Rep. 665, 72d Cong., 1st Sess., p. 39.

like, attributing to the corporation itself the "feelings" of the persons who control it, the tax law need not indulge in the same fiction and could—and, we submit, clearly should—treat a corporate payment so motivated as being made on behalf of the persons directing the payment and thus a constructive distribution to them of which they made gifts. In short, the only effect of such a state rule would be to preclude the inference from the presumption of the regularity of corporate acts that the payment was in fact made for business reasons. The reason for the payment would have to be established independently, but once established federal law, and only federal law, would govern the tax consequences.[20]

E. PAYMENTS BY INDIVIDUALS PRESENT A MORE DIFFICULT ISSUE OF FACT BUT ARE OF RELATIVELY MINOR IMPORTANCE

Because the motivations of individuals, unlike corporations, are not confined to rigid channels, it is evident that the characterization of payments by individuals will pose more difficult factual issues. If the litigated cases be a guide, however, purported

---

[20] There is perhaps one way in which the state law might control the tax consequences of its own force. If a charitable contribution made by a corporation were *ultra vires* under state law, it is perhaps arguable that the very fact that the payment was a misappropriation of corporate assets by the directors as a matter of state law would require that it be treated as a receipt by them of which they made a gift, notwithstanding that, if state law had authorized the payment, it would have been treated for tax purposes as a payment made by the corporation in its separate capacity and not on behalf of the directors or stockholders. We intimate no view on that question and since the directors would usually be entitled to an offsetting charitable deduction in any event, it is unlikely to arise.

"gifts" by individuals to employees have not been a major problem. The explanation may be that until recently (notably in the widow-bonus cases) it seems generally to have been assumed that a "gift" could not be deducted by the payor, and, since an individual making a voluntary payment to another is likely to be in a higher bracket than his donee, it is usually more advantageous (to the extent the "intent" rationale permits the payor the choice) to have the payment be deductible by the payor and taxable to the payee. Corporate officers or executives, on the other hand, are often in a higher bracket than the corporation, and there the advantage lies in obtaining gift treatment for the payee even if it is necessary to forego the deduction—at a smaller net cost to the corporation, a greater net benefit can be conferred on the "donee" executive.

The suggestion that the prospects of favorable tax treatment may have something to do with the incidence of these transactions—as witness the large number of widow bonuses after lower court rulings that they were both deductible and nontaxable—does not at all imply that taxpayers act improperly in having tax consequences in mind. They have every right to do so, and if the law permits them to determine the character of a transaction by "intending" it as one thing or another, they can properly take advantage of it and "intend" that which produces the least net tax. Our point is rather that the tax consequences ought not to turn on such an "intent" and that in part at least the problems arise only because

it does. The definition of gifts we propose—since it makes clear that a payment cannot be both a gift and deductible and, further, that a gift of corporate funds to officers, employees or their families would necessarily be a taxable distribution to the directors or stockholders—would thus accomplish a great deal even if it did not contribute to the solution of the factual questions when they arise.

In fact, however, we think the definition also contributes substantially to the resolution of the factual question even in cases of payments by individuals. The primary difficulty now encountered is that the question of "fact" is put without its ever being defined—the trier is asked to find an "intent to make a gift" without being told what the ingredients or test of such an intent is. By explicitly stating what the controlling facts are, the suggested definition at least puts the factual inquiry on a meaningful basis and tells the trier what it is he is to look for.

While the question is not directly involved in this case, completeness of analysis requires that we briefly indicate the nature of the factual issues that would be encountered in characterizing individual payments. They seem to be basically of two separate kinds: (1) where there may be two independent motives, one of which is a gift motive and the other is not, and the question is which is "dominant"; and (2) where the question is whether the causal relationship between, say, the performance of services and the payment is "proximate."

1. In any employment relationship between individuals there are likely to be developed personal bonds

from the close association, and there is thus likely to be a basis for a factual dispute whether a voluntary payment was prompted by the employer's receipt of the services or by his personal affection or like feeling for the employee. It perhaps ought to be recognized that in such situations the motives are inextricably mixed—the employer would not have made the payment but for the services, but he equally would not have done so had he not "liked" the employee—and that looking for the "dominant" one may be a fruitless search. What is required is an objective rule to govern such cases—*e.g.*, by treating the payment as compensation to the extent that it bears a reasonable relationship to the value of the services; as a gift, to the extent of the excess. In effect, that amounts simply to the accepted presumption that payments in an employment relationship are compensation, and places the burden on the employee to prove that the employment relationship was essentially a fortuitous circumstance providing only the occasion for the development of the personal relationship which prompted the payor to make a gift.

2. The more difficult problem conceptually—though not likely often to be of practical importance—is to define the kind of motivational response to the receipt of services that provides a proximate causal relationship between the services and the payment. As pointed out by a somewhat extreme example in our *Duberstein* brief (a lavish reward by a parent to the rescuer of his child, p. 17, n. 10), it is not enough to make the payment compensation that the services were a *sine qua non* of the payment or that the mo-

tive, broadly speaking, was "gratitude for services." Some further refinement of "gratitude for service" is required.

A borderline case will better illustrate the nature of the problem. Suppose that a sole proprietor of a business, having made his fortune, sells the business and retires, and is thereafter moved out of a sense of satisfaction and well-being because of his remarkable success to make a generous distribution of some of his gains to his former employees. The retiring employer may be moved less by any sense that fairness demands the payment than by his own sense of gratification with the bounties that have come to him and an out-going desire to share his good fortune with those who have had some part, though perhaps only fortuitously, in bringing it about. The causal relationship between the services and the payment is obviously much more remote than in the ordinary "bonus" case, and at some point a line must be drawn. We suggested in *Duberstein* that the distinction hinges on whether the payor feels a sense of "obligation" to make the payment, a sense that it is "right" or "fair" that something more be paid. The distinction has been better put, however, by Judge Learned Hand in *Bogardus* v. *Helvering,* 88 F. 2d 646, 648 (C.A. 2), reversed, 302 U.S. 34, which, as we shall later show (pp. 68–77), involved an essentially identical question.

Because Judge Hand's opinion so aptly states the views we have tried to express, we shall allow it to do service also as our summing up. No less in its per-

ception of the necessity of stating a question of fact before answering it than in its recognition that the question is one of motive rather than intent, it is an opinion that stands alone among the decisions of the lower courts, and the light it sheds is no less illuminating because it was so soon to be dimmed (see *infra*, pp. 68–77). Noting that "legal gifts" were not necessarily gifts for tax purposes, Judge Hand proceeded (pp. 648–649):

> * * * When the donor is not an obligor, that is, when he is under no legal sanction to make the payment, the decision must therefore depend upon his intent—perhaps more properly upon his motive—and so the courts have very generally put it. [Citations.]
>
> We have, however, not found much help in learning what that intent or motive must be, and, while the issue remains unsettled, it seems scarcely profitable to catalogue the evidence; we rather need a test by which to determine what evidence is relevant. We agree that a man may make a gift to an old employee without meaning it as "compensation"; though probably such cases will be uncommon, especially if he declares that the payment is "in recognition of" past services. We will assume that the gift would be nothing more, if for instance the donor believed that what he had paid in the past was the full measure of anything that the employee was then "entitled to"; that in fairness he did not "owe" a cent; and that anything he might give was not only beyond what the law would exact, but what the employee could in justice

demand. Even so the past services would be the cause of the gift in the sense that except for them the donor would never have been moved to spontaneous generosity, but the gift would not pay for the services. On the other hand, employers sometimes feel that their employees have never been paid in full; that their services deserved more than they have received; that the account between them is not quite in equitable balance. Such gifts are "compensation"; they are not only the result of the past relation, but they are a return specifically allocated to the donee's services. For example, a patient may increase his surgeon's bill; it would be "compensation," though a gift; yet, if he made him a present only because his skill, solicitude and kindness had bound them in a warm friendship, it would not be. A donor must not be moved to satisfy some uneasiness, some scruple, some sense that there is an outstanding claim which those would recognize to whose opinion he is sensitive: something which makes the payment more than an unconstrained act of affection or regard. * * *

* * * [After reviewing the evidence:] Left to ourselves we should therefore have been disposed to say that these gifts were actuated by a sense that in fairness the donees deserved something more than they had got in the past, now that the ship had come in. But the decision is not primarily for us at all [but for the Board, whose decision that they were so actuated and hence constituted compensation was a reasonable inference from the evidence and must therefore be affirmed] * * *.

III

THE PROPOSED DEFINITION OF GIFTS IS SUPPORTED BY THE LATER DECISIONS OF THIS COURT AND CAN BE RECONCILED WITH THE EARLIER DECISIONS TO THE EXTENT THAT THEY HAVE NOT ALREADY BEEN MODIFIED

The definition of gifts we propose is, we believe, fully supported by the more recent decisions of this Court and differs from them, if at all, only in its degree of explicitness. To the extent that the language of the earlier cases is inconsistent, we believe they have already been modified by the later cases. We will begin with the later, and we think controlling, cases, and then examine the extent to which the earlier cases are inconsistent.

A. *ROBERTSON* AND *LOBUE* SUPPORT BOTH THE CONTROLLING SIGNIFICANCE OF MOTIVE AND THE DEFINITION OF GIFT MOTIVES

The two most recent "gift" decisions of this Court, *Robertson* v. *United States*, 343 U.S. 711, and *Commissioner* v. *LoBue*, 351 U.S. 243, are, we submit, virtually conclusive authority for the two propositions that gifts turn on motive and that only essentially "personal" motives are gift motives.

1. As shown in detail in our brief in *Duberstein* (pp. 13–15), *LoBue* expressly rejected the lower courts' view that whether stock options given employees were gifts or compensation depended on whether the employer "intended" them "as compensation." There the Tax Court found, and the Court of Appeals affirmed the finding, that the employer did *not* intend the options as compensation. To this Court, however, "intent" in that sense was meaning-

less, and the only important question was *why* the options had been given—*i.e.*, whether they were motivated by "disinterested generosity" or by business reasons. *Robertson,* though in perhaps what is no more than a dictum, confirms that view in its allusion to gifts as payments made "out of" (*i.e.*, motivated by) certain kinds of "impulses." 343 U.S. at 713–714.

2. On the separate question of the kinds of motives that should be treated as gift motives, both those decisions also fully support our view that a gift can proceed only from personal, non-business motivations—*LoBue*, by summarily rejecting the notion that a payment "made by a company engaged in operating a business for a profit" (p. 246) and motivated by a business reason ("prompted by the employer's desire to get better work from him", p. 247) could be a gift: and *Robertson,* by enumerating the kinds of personal reasons out of which gifts could be made, namely, "affection, respect, admiration, charity or like impulses." 343 U.S. at 713–714.

In short, *LoBue*, supported by at least a dictum in *Robertson,* establishes the two essential ingredients of the definition urged here: that an "intent" to make a gift is not controlling; that motive, *i.e.*, the reasons why the payment was made, is controlling; and that "business" reasons are not gift motives. That is our entire position, in a nutshell; and the elaboration in Point II, *supra,* is no more than an attempt to make explicit the premises and implications of accepting those basic concepts.

B. *AMERICAN DENTAL*, TO THE EXTENT INCONSISTENT, HAS BEEN OVERRULED BY *JACOBSON, GLENSHAW GLASS*, AND *LOBUE*

The decision of the Court that seems most inconsistent with the approach later adopted by the Court in both the "gift" and the "income" field is *Helvering* v. *American Dental Co.*, 318 U.S. 322. While that case was discussed in our *Kaiser* brief (No. 55, this Term, pp. 28–29), we will restate it here in order to consolidate the discussion of the relevant decisions of this Court.

In *American Dental*, the creditors of a corporation accepted partial payment and cancelled the balance of the indebtedness, doing so, as the Board of Tax Appeals found, "for purely business reasons" and not for "altruistic reasons or out of pure generosity" (p. 330). This Court held that the cancellations were nevertheless gifts, defining a gift simply as "the receipt of financial advantages gratuitously" (p. 330). The Court apparently meant that any benefit received without obligation or consideration, regardless of the payor's motives, was a gift, for it added (p. 331):

> * * * The fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant. The forgiveness was gratuitous, a release of something to the debtor for nothing, and sufficient to make the cancellation here gifts within the statute.

The broad view thus expressed, we respectfully submit, cannot survive the later decisions of this Court and is, indeed, inconsistent in concept even with the

earlier decisions. To the extent that it holds that the motives for a transfer are irrelevant to the gift question, as it literally does, we have already shown that it is inconsistent with the later decision in *LoBue*. But the inconsistency is deeper than that, for the opinion equally abandons the "intent" language of the earlier decision in *Bogardus* v. *Commissioner*, 302 U.S. 34 (discussed *infra*, pp. 68–77), and makes the gift question turn, not at all upon what the transferor did, but solely on what the transferee got. The opinion defines a gift as the "*receipt* of financial advantages gratuitously," and not even the qualification "gratuitously" implies a reference to the transferor's state of mind, for the opinion made it clear that all it meant by that was that there was no legal obligation or bargained-for exchange. The opinion thus seemed to adopt a purely objective definition of gifts as anything *received* for which the recipient gave no consideration in the contract-law sense—in effect, any transfer that is a gift in the property law sense is a gift for tax purposes. In that respect, the opinion was, we submit, inconsistent with the principle otherwise universally accepted both by this Court (*Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716, 730; *Bogardus* v. *Commissioner*, *supra*) and the lower courts (see note 3, *supra*) that a payment made without obligation and not for a bargained-for exchange is not necessarily a gift and whether it is or not depends on some aspect of the *payor's* action (intent or motive).

American Dental can be explained, we think, only as involving a confusion of the concepts relevant to the "gift" question and those relevant to the "income" question. That one *receives* a benefit "for nothing", as we have previously noted, proves only that it is a windfall to him and presents the question whether a windfall is within the scope of the comprehensive definition of income in § 22(a). It does not, by itself, present the "gift" question, which turns instead upon some aspect of the payor's action. Thus, at least in terms of the considerations the Court deemed relevant, if not in its phrasing of the question, *American Dental*, to the extent that it can be rationalized with other cases, must be taken as a holding that windfalls are not income. That, however, while more satisfactorily explaining *American Dental* in its context, gives it no greater vitality today, for, as we show in *Kaiser* (pp. 39-40), the later decision in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, clearly establishes (despite contrary inferences previously drawn from the broad language of *Eisner* v. *Macomber*) that windfalls *are* income.

In terms of its precise holding—that gain from a cancellation of indebtedness is not taxable—*American Dental* has fared no better, for it was severely limited, if not substantially overruled, by *Commissioner* v. *Jacobson*, 336 U.S. 28. Although the Court in *Jacobson* refrained from expressly overruling *American Dental*, both a concurring opinion and a dissent written by the author of *American Dental* found no sub-

stantial difference in the cases and thought the results in conflict (p. 52).[21]

In short, we submit that whatever doctrinal significance *American Dental* may have had has been destroyed either by *LoBue* or *Glenshaw Glass* and that it is at least questionable whether even its precise holding retains any substantial vitality after *Jacobson*.

C. THE HOLDING IN *BOGARDUS* IS RECONCILABLE WITH THE SUGGESTED DEFINITION OF GIFTS AND THE OPINION LENDS AFFIRMATIVE SUPPORT TO THAT DEFINITION

It is language in this Court's opinion in *Bogardus* v. *Commissioner,* 302 U.S. 34, on which the petitioner in this case almost exclusively relies, that seems to have caused the greatest difficulty in this area and which, we believe, requires clarification. As we shall show, but for its use of the language of intent (when the Court itself seems to have meant motive), *Bogardus* can be fully reconciled with the later cases on which we rely. To show that, we will first state the facts of the transaction out of which the case arose; show how the question would be resolved under the

[21] The lower courts have similarly been unable to find a meaningful distinction and, since *Jacobson*, *American Dental* has been treated virtually a dead letter, the courts almost invariably finding that a cancellation of indebtedness is taxable and not a gift. *E.g.*, *Spear Box Co.* v. *Commissioner*, 182 F. 2d 844 (C.A. 2); *Capitol Coal Corp.* v. *Commissioner*, 250 F. 2d 361 (C.A. 2); *Bradford* v. *Commissioner*, 233 F. 2d 935 (C.A. 6); *Denman Tire & Rubber Co.* v. *Commissioner*, 192 F. 2d 261 (C.A. 6); *Pacific Magnesium Co.* v. *Westover*, 183 F. 2d 584 (C.A. 9); *Roxy Custom Clothes Corp.* v. *United States*, 171 F. Supp. 851 (Ct. Cls.). But see *Reynolds* v. *Boos*, 188 F. 2d 322 (C.A. 8), holding a debt cancellation to be a gift on the authority of *American Dental* without citing *Jacobson*.

formulation we suggest; and then consider the implications of the way in which the Court decided it.

1. The Universal Oil Products Company (Universal) was organized in 1914 having as its sole asset a patent application for a gasoline cracking process. It continued development work on the process, without significant income, until the process was perfected in 1922. The process was then universally accepted in the oil industry and Universal's royalty income grew phenomenally, from a few thousand dollars in 1922 to over $9 million in 1930. In January 1931, the stockholders sold all their stock in Universal to an oil company for $25 million, with some $4 million of the liquid assets of Universal first being transferred to a new corporation (Unopco), the stock of which was distributed pro rata to the old stockholders of Universal.

A few days after the sale was consummated, the stockholders of Unopco met informally to discuss the investment policies to be followed by their new investment company. During the meeting, the president commented on their "great good fortune," noted that they had had the "loyal support of a number of employees particularly" during the period they were "struggling and moving forward," and suggested that "it would be a nice and generous thing for us to show our appreciation and to remember them in the form of a gift or honorarium." All the shareholders "acquiesced and were glad to do it." Thereafter, the board of directors of Unopco adopted a resolution, unanimously affirmed by the stockholders, authorizing payment out of the surplus of Unopco of

a total of $607,500 to 64 former and present employees, attorneys, and expert consultants of Universal. 88 F. 2d at p. 647. The question was whether those payments were gifts or compensation to the recipients.

2. On those facts, it is clear that the question cannot be resolved by the presumption of regularity of corporate payments. There was no possible business reason or justification for the payments to be made by Unopco in its own behalf, for Unopco, as a separate corporate entity, had never had anything to do with the recipients and the payment was totally unrelated to its investment business. Rather Unopco made the payment simply as a conduit for its stockholders to recipients designated by them; constructively, the payment was a distribution by Unopco to its stockholders (taxable to them as a dividend if the other requirements were met) and a payment *by them* in their personal capacity to the ultimate recipients.

Once the problem is viewed, as the Court viewed it, as a payment by the stockholders themselves to the employees of the corporation they had sold, it becomes essentially identical to the problem discussed above pp. 60–62) of characterizing a payment by an individual proprietor who, after selling the business, makes a payment to his former employees. The question turns on how close the causal relationship was between the performance of the services and the receipt of the payment: whether, as Judge Hand expressed it in his *Bogardus* opinion, the payor was "moved to satisfy some uneasiness, some scruple, some sense that there is an outstanding claim which those

would recognize to whose opinion he is sensitive," or by "a sense that in fairness the donees deserved something more than they had got in the past," (compensation) or whether, on the other hand, there was no such sense of obligation but only an "unconstrained act of affection or regard" or of "spontaneous generosity" (gift).

That question of motivation is necessarily one of fact to be left in the first instance to the trier of fact, whose finding must control if supported by evidence. And on the facts in *Bogardus*, a finding that the payment was prompted by an unconstrained sense of generosity, with no sense that any amount was "due" in fairness or "ought" to be paid, would readily have been supportable. Of particular significance is the fact that no thought was given to the making of the distribution until after the sale had been finally consummated. Had there been a feeling that in equity something more was due the employees for their loyal service to Universal, it could be expected to have manifested itself while the stockholders were winding up their affairs in Universal and settling their accounts, particularly since any "obligation" toward the employees would be primarily an "obligation" of Universal's, properly chargeable to its books and, indeed, deductible by it. It is possible, of course, that the stockholders simply overlooked the matter until after the sale was consummated and then recognized their unsatisfied "obligation" and undertook to satisfy it out of their own pockets. It seems more consistent, however, to say that the accounts between the employees and their immediate employer, Universal, were

thought to be in full "equitable balance", in Judge Hand's phrase, and no more could properly be charged the corporation. From that it would follow that the stockholders had no sense that more was due and thus that their action was entirely spontaneous and unconstrained, moved simply by a feeling of benevolent generosity and good will.

The Board of Tax Appeals, however, had held the payments compensation, and assuming, as Judge Hand did in affirming its decision, that the Board had applied the standard which he so carefully defined and decided the question which he so carefully asked,[22] there was perhaps also enough evidence to support its decision, particularly with the presumptive correctness of the Commissioner's determination.

In short, under our view, the question of motivation framed by Judge Hand was one for the trier of fact and, although the evidence that the payment was entirely unconstrained and spontaneous was strong, there was probably sufficient evidence to support either result reached by it.

3. This Court, with four Justices dissenting, set aside the Board's findings and held the payments to be gifts. Both the majority and the dissenting opinions are significant, and both will be discussed, though starting with the dissent.

a. The brief dissenting opinion written by Mr. Justice Brandeis, although reflecting an interchangeable use of "intention" and "motive," was, we be-

---

[22] In fact, however, that seems not to have been the case. (See *Morrell* v. *Commissioner*, B.T.A. Mem. Dec., ¶36,147, Apr. 30, 1936).

lieve, essentially an endorsement of Judge Hand's more detailed analysis of the problem and of the controlling issues of fact. It said simply that, in distinguishing gifts from compensation (302 U.S. at p. 45):

> * * * What controls is the intention with which payment, however voluntary, has been made. Has it been made with the intention that services rendered in the past shall be requited more completely, though full acquittance has been given? If so, it bears a tax. Has it been made to show good will, esteem, or kindliness toward persons who happen to have served, but who are paid without thought to make requital for the service? If so, it is exempt.
>
> We think there was a question of fact whether payment to this petitioner was made with one intention or the other. * * * It was for the triers of the facts to seek among competing aims or motives the ones that dominated conduct. * * *

From the later shift to the phrase "competing aims or motives" it seems evident that the opinion did not draw a distinction between the words "intention" and "motive," and we submit that the opinion cannot be read to mean "intention" in its technical sense. Surely it is not significant that a payment is made "to show" good will, esteem, or kindliness in a literal sense—*i.e.*, to cause others to believe that the payor feels those impulses. It is significant only that the payment was prompted by those impulses, not that the payor wanted "to show" them. The opinion

seems to have used that formulation only in the sense that a payment is in fact a manifestation of the inducing motives. So also, the reference to an "intention" that services "shall be requited more completely, though full acquittance has been given," seems to be only a short-hand statement of Judge Hand's description of a payment prompted by a sense that, although "adequate" payment has been made, still in fairness something more is due. So construed, the dissenting opinion—though its failure to distinguish motive and intention has not contributed to clarity—is entirely consistent with our position.

b. The majority opinion, written by Mr. Justice Sutherland, can likewise be read as ultimately applying no different test from that articulated by Judge Hand, simply reaching a contrary conclusion on the facts that the payment was not induced by any sense that something more was owing the employees but was instead a free-flowing act of generosity. The considerations that seemed to control decision were that there was "entirely lacking the constraining force of any moral or legal duty as well as the incentive of anticipated benefit of any kind beyond the satisfaction which flows from the performance of a generous act" (p. 41); that "rejoicing in the fact of their own great good fortune, and mindful of the former loyal support" of the employees, the stockholders "were moved * * * to an act of 'spontaneous generosity'" (p. 42); that full compensation had been given and, as stipulated, "no one was under any obligation, legal or otherwise (and this would include a moral obligation, however slight)" to pay more (p. 42); and

that there was absent any "moral or other obligation" (p. 43). Those elements are clearly elements of motivation, not of "intent", and are directly responsive to Judge Hand's formulation of the issue as being whether there was some sense of obligation to make the payment or whether it was an "unconstrained" act of "spontaneous generosity." If then, as we think they were, those elements were the essential basis for the decision, it follows that *Bogardus* itself actually applied a motivation, rather than an intention, test—and, indeed, apart from the standard of review issue, did so correctly to reach a sound result.

It is true of course that the opinion also repeatedly refers to "intention," but, just as in the dissenting opinion, that shows no more than a common confusion of terms. The controlling inquiry is upon what considerations decision was made to turn and, whatever language the Court may have loosely used, we submit that *Bogardus* was decided on the basis of inquiry into the reasons for the payment, not the intent of the payor to make a gift *vel non.*

4. Apart from its loose use of "intent," there are two other aspects of *Bogardus* that have led to confusion and require clarification.

The first was the failure of the opinion to articulate precisely, as Judge Hand had done, the broad scope of the sense of "obligation" that would provide a sufficient causal relationship to make the payment compensation "for" the services. Judge Hand, to avoid the restrictive implications of "obligation," had carefully avoided that term altogether, speaking instead

of the sense that "in fairness" something more is due, or some "uneasiness" or "scruple" that is satisfied by the payment. The Court, in referring to the absence of an obligation "however slight" or of a "moral or other obligation," seems to have meant the same thing, but its use of the term "obligation" has led other courts to identify the test with the technical concepts of "legal" and "moral" obligations.

The second was the failure to emphasize that the question was peculiar to payments by individuals out of their personal funds. Although the opinion makes clear that the Court in fact viewed the transaction as essentially a payment by the stockholders themselves and not a payment by Unopco (other than as an agent for the stockholders), it did not acknowledge the necessary implication that there was a taxable distribution from Unopco to its stockholders of which they then made gifts. Because of that lack of emphasis, *Bogardus* continues to be relied upon in cases involving payments by corporations in their own behalf, which, as we have seen (pp. 40–56, *supra*), involve a very different problem and to which *Bogardus* actually has no relevance. The difference is simply that corporate funds could not properly be paid to an employee unless there *were* some such sense that in fairness something more was due, and that sense, if we properly interpret *Bogardus* in the light of Judge Hand's opinion, would without more make the payment compensation.

With those clarifications of the opinion being made explicit, there is nothing in *Bogardus* that is inconsistent with the definition of gifts urged here, and in

fact it supports the view that the controlling inquiry is into the reasons for the payment, not whether the payor "intended" to make a gift.

IV

THE PAYMENT TO PETITIONER WAS NOT A GIFT

1. Petitioner contends that the district court made a finding of fact that the payment here was a gift, that that finding was supported by evidence, and thus the district court must be sustained. Since neither the district court nor the petitioner has yet said what "fact" it was that was found, we must infer that the fact found was that the directors "intended to make a gift." We, however, not only do not challenge that finding but expressly concede that both the directors and the vestrymen sincerely "intended to make a gift" in the only sense in which that "intent", when divorced from motive, has any meaning—namely, it was their sincere desire that the payment not be taxable. Our position is rather simply that "intent" in that sense has no relevance to any meaningful definition of gifts for tax purposes.

2. If the definition of gifts we have suggested be accepted, its application to the facts of this case poses no problem. The only reason for which the directors and vestrymen could properly give to petitioner assets of the church (the assets of the operating company being ultimately assets of the church) was out of a recognition that something more was due him, on the occasion of his departure, for his long and valued services for the church—in short, as reasonable compensation for his services. That is no

doubt true as a matter of state law, for the assets are dedicated to religious purposes and could be paid to petitioner only to pay him for his labor in behalf of the church. It is true independently for federal tax purposes, since the church is exempt from federal income taxes only so long as it is "operated exclusively for religious * * * purposes" and no part of its "net earnings * * * inures to the benefit of any private * * * individual" (§ 101(6)). A payment to an officer or employee of anything more than reasonable compensation would deprive the church of its exemption. *E.g., Mabee Petroleum Corp.* v. *United States*, 203 F. 2d 872 (C.A. 5). And, finally, even if otherwise permissible, a use of church assets by the vestrymen to satisfy their personal desires—*e.g.*, to benefit a personal friend—would be a taxable distribution to them.

Unless the contention is that the several directors and vestrymen all committed a breach of trust by giving church assets to petitioner just because they liked him—and of course that is not the contention—what is the relevance of the testimony relied upon so heavily by petitioner that all the Vestry "liked" him "personally" and thought of him "in the highest regard" or that he had a "pleasing personality"? To paraphrase the Board of Tax Appeals in another case, "The payment in question was not made from [the vestrymen's] funds, but from the funds of [the church]. It is difficult to see what, if any, bearing individual friendships could have had upon the making of it. Surely it would not be contended that the [vestrymen] would give away [church] funds in token of [their] friendship for petitioner." *Van Sicklen* v. *Commis-*

sioner, 33 B.T.A. 544, 548.[23] And, of course, none of the testimony here can be read as even implying that the payment was made simply out of personal affection. Rather both the witnesses relied upon took care to show that there was a proper "business" (church business, in this instance) reason for the payment, stating that petitioner "did a splendid piece of work" in a "difficult situation" (R. 27) and that he "had loyally and faithfully served Trinity" (R. 37). It is that and only that which justified the expenditure of $20,000 of the assets dedicated to religious purposes, and it is only that which can be deemed the reason for the payment for purposes of the gift exclusion. And if that was the reason, the payment cannot be a gift. Not being a gift, it necessarily is, on the facts here, taxable as compensation.

CONCLUSION

For the reasons stated, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

J. Lee Rankin,
Solicitor General.

Charles K. Rice,
Assistant Attorney General.

Wayne G. Barnett,
Assistant to the Solicitor General.

March 1960.

[23] The same analysis equally disposes of the minister retirement-pension cases (stated *infra*, pp. 102–103) on which petitioner relies (Br. 21). While it may be that the members of a congregation feel affection for their retiring minister, the pension is paid not by them but out of regular church funds dedicated to religious purposes, and the use of those funds can be justified only as giving a faithful servant his due.

543845—60——7

APPENDIX A

INTERNAL REVENUE CODE OF 1939 (26 U.S.C., 1952 ed.)

§ 22. GROSS INCOME—(a) GENERAL DEFINITION.

"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) EXCLUSIONS FROM GROSS INCOME.

The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

(1) Life insurance, etc.

Amounts received—

(A) under a life insurance contract, paid by reason of the death of the insured; or

(B) under a contract of an employer providing for the payment of such amounts to the beneficiaries of an employee, paid by reason of the death of the employee;

* * * * *

(2) Annuities, etc.

(A) In general.

Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. * * *

* * * * *

(3) Gifts, bequests, devises, and inheritances.

The value of property acquired by gift, bequest, devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;

* * * * *

(5) Compensation for injuries or sickness.

Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 23 (x) in any prior taxable year, amounts received through accident or health insurance or under work-

men's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, and amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country;

(6) Ministers.

The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation;

* * * * *

§ 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) Trade or business expenses.

(A) In general.

All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(q) Charitable and other contributions by corporations.

In the case of a corporation, contributions or gifts payment of which is made within the taxable year to or for the use of:

(1) The United States, any State, Territory, or any political subdivision thereof or the District of Columbia, or any possession of the United States, for exclusively public purposes; or

(2) A corporation, trust, or community chest, fund, or foundation, created or organized in the United

States or in any possession thereof or under the law of the United States, or of any State or Territory, or of the District of Columbia, or of any possession of the United States, organized and operated exclusively for religious, charitable, scientific, veteran rehabilitation service, literary, or educational purposes or for the prevention of cruelty to children (but in the case of contributions or gifts to a trust, chest, fund, or foundation, payment of which is made within a taxable year beginning after December 31, 1948, only if such contributions or gifts are to be used within the United States or any of its possessions exclusively for such purposes), no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation. * * *

* * * * *

Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.)

§ 61. Gross Income Defined.

(a) General definition.

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

* * * * *

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * *

§ 71. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS.

* * * * *

§ 72. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS.

(a) GENERAL RULE FOR ANNUITIES.

Except as otherwise provided in this chapter, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

* * * * *

§ 74. PRIZES AND AWARDS.

(a) GENERAL RULE.—Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards.

(b) EXCEPTION.—Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if—

(1) the recipient was selected without any action on his part to enter the contest or proceeding; and

(2) the recipient is not required to render substantial future services as a condition to receiving the prize or award.

* * * * *

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

*   *   *   *   *

§ 101. CERTAIN DEATH BENEFITS.

(a) PROCEEDS OF LIFE INSURANCE CONTRACTS PAYABLE BY REASON OF DEATH.—

(1) GENERAL RULE.—Except as otherwise provided in paragraph (2) and in subsection (d), gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured.

*   *   *   *   *

(b) EMPLOYEES' DEATH BENEFITS.—

(1) GENERAL RULE.—Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

(2) SPECIAL RULES FOR PARAGRAPH (1).—

(A) $5,000 limitation.

The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed $5,000.

*   *   *   *   *

§ 102. GIFTS AND INHERITANCES.

(a) GENERAL RULE.—Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

(b) INCOME.—Subsection (a) shall not exclude from gross income—

(1) the income from any property referred to in subsection (a); or

(2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.

* * * * *

§ 104. Compensation for Injuries or Sickness.

(a) In General.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service.

* * * * *

§ 105. AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS.

(a) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

* * * * *

§ 107. RENTAL VALUE OF PARSONAGES.

In the case of a minister of the gospel, gross income does not include—

(1) the rental value of a home furnished to him as part of his compensation; or

(2) the rental allowance paid to him as part of his compensation, to the extent used by him to rent or provide a home.

* * * * *

§ 117. SCHOLARSHIPS AND FELLOWSHIP GRANTS.

(a) GENERAL RULE.—In the case of an individual, gross income does not include—

(1) any amount received—

(A) as a scholarship at an educational institution (as defined in section 151(e)(4)), or

(B) as a fellowship grant,

including the value of contributed services and accommodations; and

(2) any amount received to cover expenses for—

(A) travel,
(B) research,
(C) clerical help, or
(D) equipment,

which are incident to such a scholarship or to a fellowship grant, but only to the extent that the amount is so expended by the recipient.

* * * * *

(B) EXTENT OF EXCLUSION.—The amount of the scholarship or fellowship grant excluded under subsection (a)(1) in any taxable year shall be limited to an amount equal to $300 times the number of months for which the recipient received amounts under the scholarship or fellowship grant during such taxable year, except that no exclusion shall be allowed under subsection (a) after the recipient has been entitled to exclude under this section for a period of 36 months (whether or not consecutive) amounts received as a scholarship or fellowship grant while not a candidate for a degree at an educational institution (as defined in section 151(e)(4)).

* * * * *

§ 119. MEALS OR LODGING FURNISHED FOR THE CONVENIENCE OF THE EMPLOYER.

There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

* * * * *

Filed March 3, 1960
CARL W. REUSS, *Clerk*

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 13,900

UNITED STATES OF AMERICA, APPELLANT

v.

EMMA A. ALLINGER, INDIVIDUALLY, AND EMMA A. ALLINGER, RUTH E. GIBSON AND G. LINCOLN GIBSON, JR., AS TRUSTEES UNDER THE WILL OF CHARLES E. ALLINGER, DECEASED, APPELLEES

Decided March 3, 1960

On Appeal from the Judgment of the United States District Court for the Eastern District of Michigan

Before CECIL and WEICK, *Circuit Judges,* and KENT, *District Judge*

Per curiam: The sole question in this case is whether the sum of $35,000 paid by The Chas. A. Strelinger Company to Emma A. Allinger, widow of Charles E. Allinger, is taxable income or exempt as gifts under Section 22(b)(3) of the Internal Revenue Code of 1939.

The facts are not really disputed and according to the "findings" of the Trial Judge are briefly as follows: The Strelinger Company is a corporation organized under the laws of Michigan and was sub-

stantially owned by the Charles T. Bush and Charles E. Allinger families. Bush and Allinger owned, respectively, approximately 30 and 37% of the stock. About five percent of the stock was owned outside of the two families. The two principal stockholders had been employed by the Company for more than fifty years at the time of the death of Allinger in 1951, and at that time and for several years prior thereto each had received an annual salary of $35,000. The directors were Charles T. Bush, his son A. Stansell T. Bush, Charles E. Allinger and his son-in-law, G. Lincoln Gibson, Jr.

In 1947 the two principal stockholders, by reason of age and health, became concerned about what would happen to their wives in the event of their deaths. Thereupon, they made mutual promises that if either one predeceased his wife the Company would pay to the surviving spouse an amount equal to the salary of the deceased at the time of the death for a period not to exceed one year. These promises were discussed with the respective families.

About a month after the death of Allinger, the Board of Directors met and passed a resolution, as follows: "Resolved, that in confirmation of a voluntary agreement previously entered into as of October, 1948, the Chas. A. Strelinger Company, in consideration for past services, shall voluntarily, upon the death of Chas. T. Bush or Charles E. Allinger, pay to the widow of its president, Chas. T. Bush, or its secretary-treasurer, Charles E. Allinger, an amount equal to the salary of said Bush or Allinger at the time of such death for a period not to exceed one year from the date of such death, and be it"—

It was further resolved that if either wife should predecease her husband or die before the full amount

equal to a year's salary had been paid, the money was to be paid to the respective estates.

The wives were not required to perform any duties or make any contribution to the Company. The duties and responsibilities of Mr. Allinger were not intended to be increased and were not increased as a result of his understanding with Mr. Bush.

Mrs. Allinger received $35,000, the full amount of a year's salary, during the years 1951 and 1952. She paid the tax and then brought this action to recover it back for the reason that it had been unlawfully collected. The Trial Judge found that the payments to Emma A. Allinger, by the Company, were "voluntary gratuities" and not subject to tax.

"The question presented is one of fact. Whether the payment was a gift or taxable income * * * depends upon the intention of the parties, particularly that of the donor. The intent of the donor is to be determined from a consideration of all the facts and circumstances surrounding the payment." *U.S.* v. *Bankston,* 254 F. 2d 541 (C.A. 6). Intention must govern. *Bogardus* v. *Com. of Internal Rev.,* 302 U.S. 34, 43.

There are many cases on the subject but the thread running through all of them is that each case must be judged upon its own merits. There is no exact standard of measurement. The court must consider the peculiar facts of each case and determine whether from them an intention to make a gift is manifested and if the facts logically and reasonably support such a conclusion. See the following cases:

Commissioner of Internal Revenue v. *Jacobson,* 336 U.S. 28, 51; *Bounds* v. *United States,* 262 F. 2d 876, 884 (C.A. 4); *Peters* v. *Smith,* 221 F. 2d 721 (C.A. 3).

The Trial Judge made a careful and comprehensive "findings of fact" and drew his inferences and con-

clusions therefrom. He had an opportunity to observe the witnesses and form a judgment of their sincerity, honesty and intentions not available to a reviewing court. We are of the opinion that the facts as found warrant the conclusions and inferences which he drew from them. Under Rule 52(a) F.R.C.P. we are not to disturb those "findings" unless clearly erroneous.

This rule is applicable to inferences drawn from documents or undisputed facts. *United States* v. *Gypsum Co.,* 333 U.S. 364, 394.

"Even where there is no dispute about the facts, if different reasonable inferences may be fairly drawn from the evidence, we are forbidden to disturb the findings based on such inferences unless they are clearly erroneous." *Central Ry. Signal Co.* v. *Longden,* 194 F. 2d 310, 318; *Rich* v. *Pappas,* 229 F. 2d 308, 313 (C.A. 6).

"A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." *United States* v. *Gypsum Co.,* cited above; *McAllister* v. *United States,* 348 U.S. 19, 20.

Upon a consideration of the entire record, we are not left with any "definite and firm conviction that a mistake has been committed."

The judgment of the District Court will be affirmed upon the findings and conclusions of the Trial Judge.

APPENDIX C

I. Payments to Current Employees

Blair v. *Rosseter,* 33 F. 2d 286 (C.A. 9): At annual stockholders' meeting, stockholders adopted resolution making $50,000 "gift" to president "in recognition of his able and successful direction" of the company for the past 10 years. Held, *gift:* intent clear from resolution, and so treated by corporation (charged to surplus and not deducted).

Levey v. *Helvering,* 68 F. 2d 401 (C.A.D.C.): Each year for 7 years the directors resolved "as a gift from the company and not as extra compensation" to pay the income taxes of the five top officers. Held, *compensation.* Words not controlling. To ascertain intent, look to motive, and motive obviously to assure full salaries undiminished by taxes. Also consideration of past and future services. And if not for services, improper.

Yuengling v. *Commissioner,* 69 F. 2d 971 (C.A. 3): Corporation paid premiums on life insurance policy in favor of wife and children of president and sole stockholder. Held, *compensation.* "A corporation cannot lawfully give away its assets."

Fitch v. *Helvering,* 70 F. 2d 583 (C.A. 8): Directors cancelled $25,000 debt of its president and 90% stockholder, there being testimony they were moved by sympathy because of his domestic troubles and ill health. Held, *not gift* (though found to be dividend rather than compensation). Gift is transfer without consideration. Though some "earmarks" of gift, are

543845—60——8

"some facts" the other way. May have been to distribute profits to president before his wife got 25% of the stock in a divorce settlement. Moreover, directors without authority to give away assets. Anyway, evidence doesn't "compel" conclusion of gift and Board justified in concluding that received as stockholder.

Commissioner v. *Bonwit*, 87 F. 2d 764 (C.A. 2): Corporation paid premiums on life insurance policy irrevocably naming president's wife and children as beneficiaries. Held, *compensation:* though Board found that not "intended" as compensation, presumption that officers did not make illegal gift of corporate assets; confirmed by deduction of premiums, showing didn't "regard" as gift.

Chandler v. *Commissioner*, 119 F. 2d 623 (C.A. 3): President occupied house owned by corporation. Rental value held *compensation* because a corporation has no capacity for affection.

Nickelsburg v. *Commissioner*, 154 F. 2d 70 (C.A. 2): President (and 74% stockholder) of corporation voted "wedding gift" of $7,500 by directors "in recognition of" his past services; charged to surplus. Held, *compensation:* that called gift, charged to surplus, and not deducted is evidence of gift; but also said in "recognition" of services, and up to the Tax Court to resolve the conflict.

Peacock v. *Commissioner*, 256 F. 2d 160 (C.A. 5): The president of a corporation and his mother occupied a house, at nominal rental, which they had transferred to a corporation owned by them. Rental value held *gift*, reversing Tax Court: no evidence that to ~~it~~ be regarded as compensation. A gift from the corporation to its stockholders.

Van Sicklen v. *Commissioner*, 33 B.T.A. 544: Investment corporation made Christmas "gifts" to most

officers and employees, equal to half of salary, specifically saying that to be treated as nontaxable gift; charged directly to surplus. Held, *compensation:* words not controlling; made only to officers and employees; measured by salary; can be explained only as compensation.

Laurie v. *Commissioner,* 12 T.C. 86: At a time when wages were frozen, the husband-partner of a husband-wife partnership gave an employee and long-time personal friend $1500 as a personal "gift" from himself, making similar gifts to three other employees. Held, *compensation.* That called and treated as gifts not controlling; "intention" turns on all the facts, which show that compensation; called gift only because of wage freeze.

II. Payments to Employees Upon Sale of Stock

Jones v. *Commissioner,* 31 F. 2d 755 (C.A. 3): Out of the proceeds of the sale of all the stock of a corporation, $300,000 was set aside and distributed to the entire administrative staff. A proposal to have the corporation make the payments had been rejected on advice of counsel that improper. Held, *gift* because no obligation of, or consideration to, the stockholders; paid out of their assets, not the corporation's.

Bass v. *Hawley,* 62 F. 2d 721 (C.A. 5): Railroad holding company sold stock of subsidiary under plan approved by its stockholders which authorized distribution of $1 million of proceeds to employees of subsidiary. Held, *compensation.* Payments made "because of past labor" are compensation; not a gift unless made "only because of personal affection or regard or pity, or from general motives of philanthropy or charity."

Barnes v. *Commissioner,* 17 B.T.A. 1002: Same transaction as *Bass.* Held, *gift* because delivery, ac-

ceptance, and intent. Paid without obligation or consideration; desire only "fittingly to reward past services" from which had indirectly benefited. *Overruled* in ***Schumacher* v. *Commissioner,*** 27 B.T.A. 895, on authority of ***Bass.***

III. Payments to Employees Upon Termination of Employment

Daly v. ***Commissioner,*** 3 B.T.A. 1042: Directors (president and another) voted president, who was too ill to perform duties, "gifts" of $72,000, which it charged to surplus and did not deduct. Held, *gift.* Delivery, acceptance, and an "intention to give" shown by calling "gifts", charging to surplus, and not deducting. Disapproved in ***Van Sicklin* v. *Commissioner,*** 33 B.T.A. 544.

Beatty's Estate* v. *Commissioner, 7 B.T.A. 726: Director of Fine Arts Department of Carnegie Institute, retired for ill health after 30 years, was made Director Emeritus with an "honorarium" of $500 per month. Held, ***compensation:*** for gift, must be intent, delivery, and acceptance but without consideration. Past services may be consideration and can't say they weren't here. Also directors without authority to give away assets.

Garey v. ***Commissioner,*** 16 B.T.A. 274: Employee resigned after 23 years, and directors resolved to continue his "salary" for balance of year, deducting the payment. Held, ***compensation.*** Depends on whether "intended" as a gift or compensation and the only evidence of intention, that called "salary" and deducted, negatives intention to make gift. Shouldn't impute "intent" to make gift because would be illegal application of funds.

Landon v. ***Commissioner,*** 16 B.T.A. 907: Officers who were replaced in a corporate reorganization were

given payments based on salary. Held, *compensation.* Gift requires delivery, acceptance and intention to make gift, and must be without consideration. No evidence of who authorized payments or how considered by corporation. That payments were based on salary indicates they were in consideration of past services, but in any event evidence inadequate to establish gift.

Binger v. *Commissioner,* 22 B.T.A. 111: Before merger of an insurance association with another company, directors voted president, who had served without compensation, a "gift" of $5,000. Held, *compensation.* For gift, must be intent to make gift and without consideration, and can't say without consideration. And directors without authority to give away assets.

Lougee v. *Commissioner,* 26 B.T.A. 23: Upon employee's resignation after 40 years, his salary was continued for 9 months. Held, *compensation.* Question of intention. President referred to it as an "obligation" and as "salary"; treated on books as expense and deducted. Board's resolution of conflicting evidence supported.

Anderson v. *Commissioner,* 31 B.T.A. 197, affirmed *per curiam,* 79 F. 2d 979 (C.A. 2): Secretary of corporation, upon resignation, voted $135,000 "in recognition of" services by directors. Held *compensation* because: said "in recognition of" services; directors thought it would be taxable; directors without authority to make gifts; and corporation treated as expense and deducted.

Knowles v. *Commissioner,* 5 T.C. 525: A teacher's retirement fund of a discontinued school being inadequate to provide for all the precipitated retirements, the institute operating the school contributed $58,000 to permit reasonable lump settlements, having obtained a special act of the legislature to permit use

of its assets for "a payment of pensions, retirement allowances or other sums" to its former employees. Held, *gift.* "It is apparent that the institute intended to make a gift." Had already given severance pay and under no moral or legal obligation to do more. No less a gift because inspired by past services.

Beggy v. *Commissioner,* 23 T.C. 736, affirmed *per curiam,* 226 F. 2d 584 (C.A. 3): Vice President, retiring before his rights had vested under a new pension plan, voted $26,000 (equivalent to rights he would have had) by directors. Held, *compensation.* Directors "didn't have in mind the making of a gift" but felt moral obligation.

Walker v. *Commissioner,* 25 T.C. 832: Upon resignation of vice president for ill health, directors resolved that "a gift" of $11,000 be made "as a token of appreciation" for his loyal services. Held, *compensation.* Although called gift, evidence as whole shows intended to reward more completely; said "appreciation" for services; testimony that payment would not have been made but for services; deducted; not approved by stockholders.

Fisher v. *Commissioner,* 59 F. 2d 192 (C.A. 2): Employee, resigning after 24 years, was paid $6,000 by officers in addition to salary. Held, *compensation.* Question is one of intention, and intention clearly indicated by treating as expense and deducting. That president of holding company approved doesn't mean gift; he had no authority to give away corporate assets.

Cunningham v. *Commissioner,* 67 F. 2d 205 (C.A. 3): When new owners took over corporation, president offered his resignation. Directors accepted and, with stockholder ratification, resolved, "in appreciation of" his "excellent guidance" of corporation in

past, payment of $15,000 as "honorarium." Held *gift* because without obligation and "treated" as gift by directors in obtaining stockholder approval.

Botchford v. *Commissioner,* 81 F. 2d 914 (C.A. 9): Vice president, after 14 years' service, resigned for ill health. Executive committee recommended that directors consider "remuneration"; directors resolved to pay year's salary, reciting his service for "many years", and his inability to get other work. Held, *compensation.* Gift is transfer with intent to make gift and without consideration. Directors testified that intended gift, but resolution recites services; executive committee spoke of "remuneration"; corporation deducted; and stockholders didn't ratify. Board of Tax Appeals' resolution of conflicting evidence final.

Willkie v. *Commissioner,* 127 F. 2d 953 (C.A. 6): Executive resigned because of dissatisfaction with policies; directors resolved that be given $15,000 "in appreciation" of services. Held, *compensation.* Intent inferred from fact that measured by salary; language; deduction; and treatment on books as salary.

Carragan v. *Commissioner,* 197 F. 2d 246 (C.A. 2): Upon liquidation of corporation, executive voted $19,000 in resolution reciting that past compensation inadequate. Held, *compensation.* Though no obligation or anticipated benefit, enough that services "motivated" payment; Tax Court was entitled to "disbelieve" testimony of director that "conceived" of payment as gift.

Peters v. *Smith,* 221 F. 2d 721 (C.A. 3): A department store employee retired for old age was given an annuity contract paying $25 per week. In giving pensions, the corporation had no established plan, treating each case on an ad hoc basis, taking into account length of service, other resources, etc. No one retired

so long as physically able to work. Held, *gift*. Since pensions to aged employees widely recognized way of requiting past services, some "inference" that compensation from that alone, but jury could have found "donative intent" from facts that: ad hoc procedure; no one "entitled" to retire at pension, only if disabled; took into account employee's needs.

IV. Minister Retirement Pensions

Schall v. *Commissioner,* 174 F. 2d 893 (C.A. 5): Pastor resigned after 18 years because of illness. The congregation "moved by affectionate regard for him and gratitude" for his "valued ministry" resolved that he be given $2,000 per year. Held *gift,* reversing the Tax Court: manifestly bestowed only out of personal affection and regard.

Mutch v. *Commissioner,* 209 F. 2d 390 (C.A. 3): Minister retired after 24 years; Session Elders thought his resources inadequate for him to live "as we would like our old minister to live"; gave him "honorarium" of $170 per month. Held, *gift:* motivated solely by the congregation's affection for the minister.

Hershman v. *Kavanagh,* 120 F. Supp. 956 (E.D. Mich.), affirmed, 210 F. 2d 654 (C.A. 6): Upon a rabbi's retirement after 39 years, the Board of Trustees recommended to the membership, and they adopted, a resolution that the $5,000 pension previously provided for was inadequate and his "retirement compensation shall be" $7,500. The increase held, *gift:* no obligation; "intended to make gifts"; inspired by feeling that pension inadequate and admiration, affection, and esteem.

Abernethy v. *Commissioner,* 211 F. 2d 651 (C.A. D.C.): Pastor, retiring after twenty years service, voted $200 monthly pension by membership "as a

token of its gratitude and appreciation." Tax Court held compensation, since no more than "justly due." Court of appeals held *gift*, on authority of *Schall*, *Mutch*, and *Hershman*.

Rev. Rul. 55–422 (1955–1 Cum. Bull. 14): The Service announced that it would accept the rulings in the above cases on their particular facts.

V. Payments to Employee's Estate

Bausch's Estate v. *Commissioner*, 186 F. 2d 313 (C.A. 2): On death of third of four key officers, corporation paid year's salary to estate, as had done to widow and estate of first two. Held, *compensation*. Tax Court could "infer" that was a reward for past services from: deduction, consistent practice, and measurement by salary.

Brayton v. *Welch*, 39 F. Supp. 537 (D. Mass.): Upon death of treasurer, directors voted to continue "salary" for one year to estate, and deducted. Held, *compensation*. Question whether "intended" as gift or compensation. Testimony of directors that intended as gift outweighed by: calling "salary" in resolution; lack of stockholder approval, since directors can't make gifts; claim of deduction, which shows didn't "regard" as gift; and payment to estate rather than family.

V. Widow Bonuses

I.T. 3329, 1939–2 Cum. Bull. 153: Amount of a deceased employee's salary paid to his widow or his heirs for a limited period is deductible as a business expense. The payments constitute gifts to the widow since when "an allowance is paid by an organization to which the recipient has rendered no services, the amount is deemed to be a gift or gratuity."

Aprill v. *Commissioner,* 13 T.C. 707: Widow of president, owning 75% of the stock, voted $36,000 "in recognition of" husband's services by directors and stockholders. Held, *gift* notwithstanding "recognition" language and corporation's deduction because I.T. 3329 said it was.

Macfarlane v. *Commissioner,* 19 T.C. 9: Upon death of executive, president directed that salary for rest of the year and the same voluntary bonus that he had received in the preceding year be paid to his widow ($67,000). Held, *gift.* Question of intent, and president was specifically advised that could make it as a gift and yet deduct it under I.T. 3229. Particularly significant that to widow, not estate.

I.T. 4027, 1950–2 Cum. Bull. 9: I.T. 3329 misconstrued the regulations, which apply only to "pensions awarded *by one to whom* no services have been rendered," which was intended to cover such transactions as payments made by the Carnegie Foundation to teachers. Irrelevant that recipient performed no services, if services were performed for the payor. I.T. 3329 will not be followed as to any payments made after 1950.

Hellstrom v. *Commissioner,* 24 T.C. 916: Upon death of founder and president (owning, with wife, 35% of stock), directors resolved, "in recognition of" his services and "in conformity with the policy of this corporation to make reasonable provision for" dependents of deceased officers and employees, to pay salary for balance of the year ($29,000) to his widow, deducting the payment. Held, *gift:* "in recognition" language irrelevant, since obviously in all cases "the basic reason for the payment is because of the deceased employee's association with the corporation." Where a payment "is" a gift, as "whole record" here establishes, statement of reasons for it doesn't change

it—the necessary meaning of statement in *Bogardus* "that a gift is nonetheless a gift because inspired by gratitude for past faithful service." *Aprill* and *MacFarlane* control; while decided before I.T. 4027, Commissioner "cannot by administrative ruling tax as ordinary income a payment which the payor made and intended as a gift." Against other evidence, deduction and measurement by salary not particularly significant. The controlling facts here which establish a gift are (p. 920):

> that the payment was made to petitioner and not to her husband's estate; that there was no obligation on the part of the corporation to pay any additional compensation to petitioner's husband; it derived no benefit from the payment; petitioner performed no services for the corporation and, as heretofore noted, those of her husband had been fully compensated for. We think the principal motive of the corporation in making the payment was its desire to do an act of kindness for petitioner. * * *

Maycann v. *Commissioner,* 29 T.C. 81: Upon death of president (who, with wife, owned 60% of the stock), directors resolved that "in recognition" of his services, widow be paid $19,400, which was deducted. Held, *gift.* Intent governs, and four directors testified that intended as a gift; husband had been fully paid; no obligation; widow rendered no services.

Luntz v. *Commissioner,* 29 T.C. 647: Upon death of president of corporation owned by him and 3 brothers, directors resolved to pay widow $96,000 "in consideration of" his past services, also resolving to make equivalent payments to the widows of the other brothers. The corporation deducted the payment. Held, *gift.* "Intent" to make gift inferred from facts that widow performed no service; no obligation; no benefit to corporation; and husband had been fully paid. The

simultaneous authorization of future widow benefits casts some doubt on "intent", but were separable.

Lengsfield v. *Commissioner*, 241 F. 2d 508 (C.A. 5): A corporation owned by 7 brothers and sisters paid $500 per month to the widows of three of the brothers or brothers-in-law, in each case as a "gratuity" in "recognition" of the deceased employee's services. The three widows together owned 63% of the stock. Held, *dividends:* whether gift a question of fact and on all evidence Tax Court concluded that dividends. There were earnings and profits, and payments were charged to surplus. Consented to by other stockholders. Fits the definition of a dividend.

United States v. *Bankston*, 254 F. 2d 641 (C.A. 6): Upon death of president (who, with wife, owned 88% of stock), directors resolved that $30,000 be paid his widow "in recognition" of his services. Held, *gift:* question of fact, depending on intention of payor to be inferred from all circumstances, so must affirm district court's finding.

Simpson v. *United States*, 261 F. 2d 497 (C.A. 7): Widow of executive vice-president paid $33,750 under standing resolution to pay 9 months' salary to widows of chief officers, deducting as salary. Held, *compensation:* even if not enforcible, an inducement to officers to remain. Clear that no "intent" to make gift, since can't be contended that can deduct a gift. Also a moral obligation.

Bounds v. *United States*, 262 F. 2d 876 (C.A. 4): Upon president's death, directors of family corporation (owned 50% by president's family and 50% by family of cousin raised by him) voted widow $40,000 "in recognition" of and as "additional compensation for" his services, which the corporation deducted. Held, *gift*, reversing district court. Since widow performed no services, presume gift; president had been

fully paid and no moral obligation arising from established plan; "words" used by directors not controlling; had they "regarded" it as compensation, they would have paid it to his estate; irrelevant under *Bogardus* that "motivated" by services.

Rodner v. *United States,* 149 F. Supp. 233 (S.D. N.Y.): Widow of vice president of subsidiary paid $13,000 at direction of officers of parent, who took into account only length and character of service, not widow's needs. Similar payments made to widows of every executive or professional employee who had died during past 7 years (9 in all). Held, *gift:* paid to widow, not estate; no legal or moral obligation; practice hadn't yet become an enforcible plan.

Jackson v. *Granquist,* 169 F. Supp. 442 (D. Oreg.): Upon the death of the president of a corporation owned ⅓ by him and ⅔ by his mother, the directors resolved that "in recognition of" his services $24,000 be paid to his widow. Held, *gift.* The corporation "intended to make gifts" since: payment to widow rather than estate; no obligation; no benefit to corporation; widow performed no services; and his services had been adequately compensated.

Internal Revenue Service Technical Information Release No. 87, August 25, 1958: In view of the number of adverse court decisions [of which the above are only a few], the Service "will no longer litigate" widow bonus cases arising under the Internal Revenue Code of 1939 except in exceptional circumstances. The policy does not apply to 1954 Code cases.

VI. Advertising Prizes

Washburn v. *Commissioner,* 5 T.C. 1333: "Pot O' Gold" radio show picked name from telephone book and gave $900. Held, *gift:* none of the earmarks of

income, no capital, no labor; came totally without effort.

Campeau v. *Commissioner,* 24 T.C. 370: Radio show telephoned persons at random and gave prizes for correct answers to simple questions. Held, *gift* because performed no services.

Glenn v. *Bates,* 217 F. 2d 535 (C.A. 6): Automobile dealer advertised that car would be given away by drawing of names registered at showroom. Held, *gift* because winner did nothing and advertisement said car would be "given" away.

Fernandez v. *Fahs,* 144 F. Supp. 630 (S.D. Fla.): Baseball club advertised that car to be given away by drawing of ticket stubs. Held, *gift* because winner did nothing (an avid fan who went to all the games anyway), the fact that the advertisement said the car would be "given" away also having an "important bearing" on the outcome.

U.S. GOVERNMENT PRINTING OFFICE: 1960